Section 13

Annual report to stockholders and the U.S. securities and exchange commission.

Section 13. ***Annual report to stockholders and the U.S. securities and exchange commission.*** **This section shall contain the following: (i) The most recent annual report of the utility to its stockholders, and if the utility is a subsidiary of a parent corporation, the most recent annual report of the parent corporation to its stockholders; and (ii) if applicable, a copy of the most recent form 10-K filed with the U.S. securities and exchange commission.**

2006 Annual Report

Kansas Electric Power Cooperative, Inc.

The Power of Human Connections

2006 KEPCo Annual Report

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Employees

Stephen Parr ....Executive Vice President & Chief Executive Officer

Tom Grennan ....Senior Vice President & Chief Operating Officer

Bob Bowser..........................Vice President of Regulatory & Technical Services

Les Evans........................ Vice President of Power Supply

J. Michael Peters............Vice President of Administration & General Counsel

Coleen Wells .... Vice President of Finance & Controller

Laura Armstrong ....Administrative Assistant

Mark Barbee............................. Manager of Engineering, KSI Vice President of Engineering

Sam Delap ....Information System Specialist

Terry Deutscher ....Sr. SCADA/Metering Technician - Ellsworth

Carol Killingsworth .... Operations Analyst

Shari Koch .... Accounting, Payroll & Benefits Specialist

Elizabeth Lesline......Administrative Assistant/Receptionist

Mitch Long ....Sr. SCADA/Metering Technician - Topeka

Loren Medley .... Business Development Coordinator

Michael Morris.......................................SCADA/Metering Technician - Wichita

Erika Old ....Finance & Benefits Analyst 2

Matt Ottman ....Engineer 2

John Payne ....Senior Engineer

Robert Peterson .... Sr. Engineering Technician

Rita Petty .... Executive Assistant & Manager of Office Services

Paul Stone... System Operator

Phil Wages...........................Director of Member Services & External Affairs

Organization & Resources

Kansas Electric Power Cooperative, Inc. (KEPCo), headquartered at Topeka, Kansas, was incorporated in 1975 as a not-for-profit generation and transmission cooperative (G&T). It is KEPCo's responsibility to procure an adequate and reliable power supply for its nineteen distribution Rural Electric Cooperative Members at a reasonable cost.

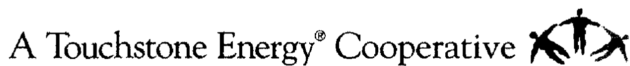
Through their combined resources, KEPCo Members support a wide range of other services such as rural economic development, marketing and diversification opportunities, power requirement and engineering studies, rate design, etc.

KEPCo is governed by a Board of Trustees representing each of its nineteen Members which collectively serve more than 100,000 electric meters in two-thirds of rural Kansas. The KEPCo Board of Trustees meets regularly to establish policies and act on issues that often include recommendations from working committees of the Board and KEPCo Staff. The Board also elects a seven-person Executive Committee which includes the President, Vice President, Secretary, Treasurer, and three additional Executive Committee members.

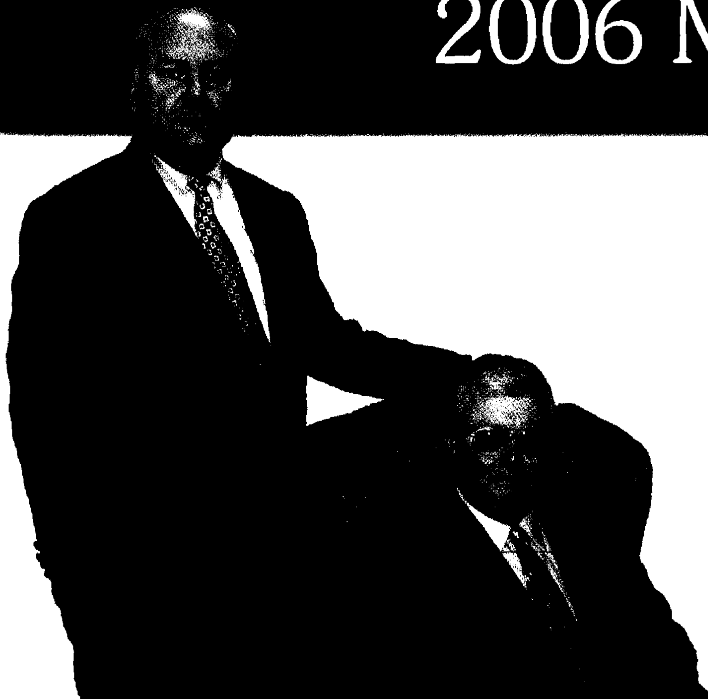
KEPCo is under the jurisdiction of the Kansas Corporation Commission (KCC) and was granted a limited certificate of convenience and authority in 1980 to act as a G&T public utility. KEPCo's power supply resources consist of: 70 MW of owned generation from the Wolf Creek Generating Station; the 20 MW Sharpe Generating Station located in Coffey County; hydropower purchases of an equivalent 100 MW from the Southwestern Power Administration, and 14 MW from the Western Area Power Administration; plus partial requirement power purchases from regional utilities.

KEPCo is a Touchstone Energy® Cooperative. Touchstone Energy® is a nationwide alliance of more than 625 cooperatives committed to promoting the core strengths of electric cooperatives – integrity, accountability, innovation, personal service and a legacy of community commitment. The national program is anchored by the motto "The Power of Human Connections."

Kansas Electric
Power Cooperative, Inc.
P.O. Box 4877 Topeka, KS 66604
600 SW Corporate View Topeka, KS 66615
(785) 273-7010 www.kepco.org



2006 Message



Mr. Parr and Mr. Maginley

from

Kenneth J. Maginley
KEPCo President

Stephen E. Parr,
Executive Vice President
& Chief Executive Officer

Reflection, by definition, is the activity of a person to consider and evaluate past experiences and events and the impact they will have on the future. The strategic business decisions made in 2006 will likely be reflected upon for many years to come, as it was a year that focused on the stabilizing and strengthening of KEPCo's long-term power supply resources needed to serve its Member Distribution Cooperatives and their Consumer-Owners.

After enduring the past few years, KEPCo realized that the practice of using short-term purchase power agreements, relying on increasing amounts of natural gas-fired generation, and purchasing power priced by the spot markets are no longer prudent business plans. Energy markets and natural gas have proven to be volatile, unpredictable and very high cost. As such, utilities across the country are reducing their vulnerability to short-term markets by building additional generation and are actively pursuing resources with fuels, such as coal, that offset exposure to natural gas generation.

However, the utility industry is entering a time of political and environmental concern surrounding global warming and climate change. Heightened pressure has been levied against the utility industry to reduce emissions from coal-fired generating units. Speculation has risen that coal-fired generation may face certain taxes and externality costs that could make the resource uneconomical. If low-cost coal generation is excised out of future resource options, the economic consequences will be substantial, an outcome that policy-makers, both on state and federal levels, need to acknowledge.

KEPCo is proud of the fact that nearly fifty percent of its energy resource mix, nuclear and hydroelectric, do not emit any greenhouse gases. This statement likely can not be made by any utility east of the Rockies. KEPCo was an environmentally-conscious utility long before global warming became a national issue and we fully intend to continue to be one.

In keeping with emission reduction, KEPCo realizes that one of the simplest ways to reduce emissions is to reduce energy consumption. KEPCo has embraced the increased interest in energy efficiency and conservation by revamping one of its long-standing programs into one that rewards choosing energy efficient, electric heating

and cooling systems. This program not only benefits KEPCo and its Members, but the Owner-Consumers and the environment as well.

Fundamental to KEPCo's longevity and continued viability was the extension of the Wholesale Power Contracts between KEPCo and its Members to 2045. The extension illustrates the confidence of its Member Electric Cooperatives in KEPCo's ability to meet the Membership's energy needs and requirements in an economical manner for decades to come.

Recognizing the need to own additional base load generation, and central to KEPCo's transition, was the commitment made by KEPCo and its Board of Trustees to acquire a 30 MW ownership participation in Iatan 2, an 850 MW high efficiency coal-fired power plant, with state-of-the-art environmental controls. Iatan 2 is under construction at Kansas City Power & Light's existing Iatan Generating Station site in Platte County, MO, and has a projected in-service date of 2010. Even though uncertainty exists about possible added taxes or costs associated with coal-fired generation, this decision is a key component in KEPCo providing its Members with economical and reliable generation and mitigating future exposure to volatile and high-priced electric markets and natural gas prices.

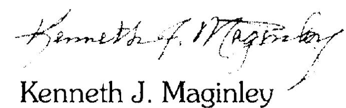
Given the energy markets as they are today, securing an economical and reliable power supply is of paramount importance. As part of KEPCo's focus on long-term resources, KEPCo negotiated a new purchase power agreement to 2018 with Sunflower Electric Power Corporation. The agreement will provide for approximately ten percent of KEPCo's power requirements.

2006-07 KEPCo Executive Committee (seated): Harlow Haney; Melroy Kopsa; Robert Reece; (standing) Stephen Parr, Executive Vice President & CEO, Kenneth Maginley, President; Kirk Thompson Vice President; Bryan Coover, Treasurer; and Gordon Coulter, Secretary.

In addition, KEPCo continued to develop its long-standing partnership with Westar through negotiations of a new long-term purchase power agreement. KEPCo's valuable relationship with Westar is a key component of KEPCo's power supply for its Members. This new contract, anticipated to be completed in early 2007, will solidify KEPCo's resource mix by allowing access to numerous generating units and will continue for the same time period as the extended Wholesale Power Contracts with KEPCo's Members.

KEPCo's ongoing success is made possible by the continued support and diligent efforts of KEPCo's Members, Board of Trustees and the dedication of a highly skilled staff. All of their efforts are appreciated and applauded. Several of Staff's accomplishments are detailed in this annual report.

The passage of time is marked by milestones and events that are recalled for generations. The decision to create KEPCo and to participate in the ownership of Wolf Creek, and the events leading to those decisions, can be recalled today as if they happened yesterday. As KEPCo continues on its transitional path, the business decisions of 2006 may well evoke the same recollection for years to come. Future business decisions for KEPCo will be based on thoughtful plans and sound business principles, which will enable KEPCo to provide a long-term, reliable and economical electric supply for its Members and for rural Kansas.



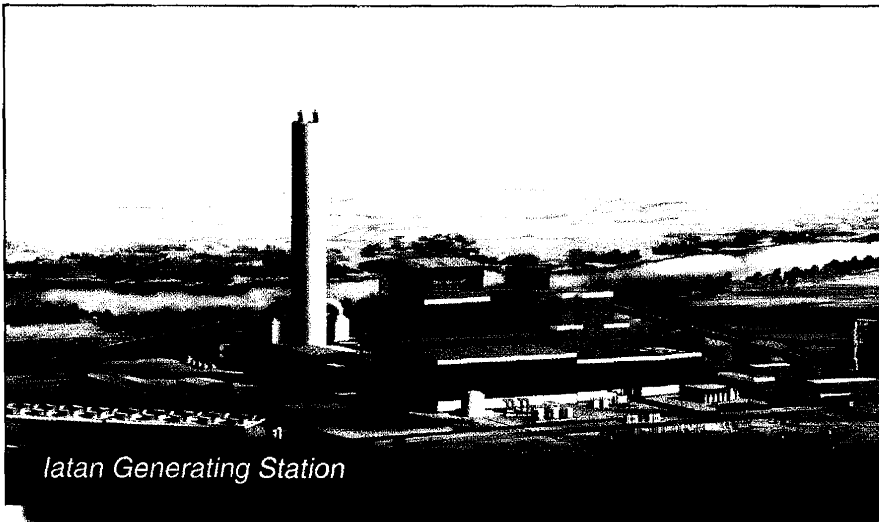
Kenneth J. Maginley

Stephen E. Parr

2006 KEPCo Highlights

KEPCo completed efforts to extend Member contracts to 2045 which provides the basis and security needed for future resource acquisitions.

In May, KEPCo executed documents to acquire a 30 MW ownership participation in Iatan 2, an 850 MW high-efficiency, coal-fired power plant, with state-of-the-art environmental controls. Iatan 2 is to be constructed by KCP&L at the existing Iatan Generating Station site in Platte County, MO.



Iatan Generating Station

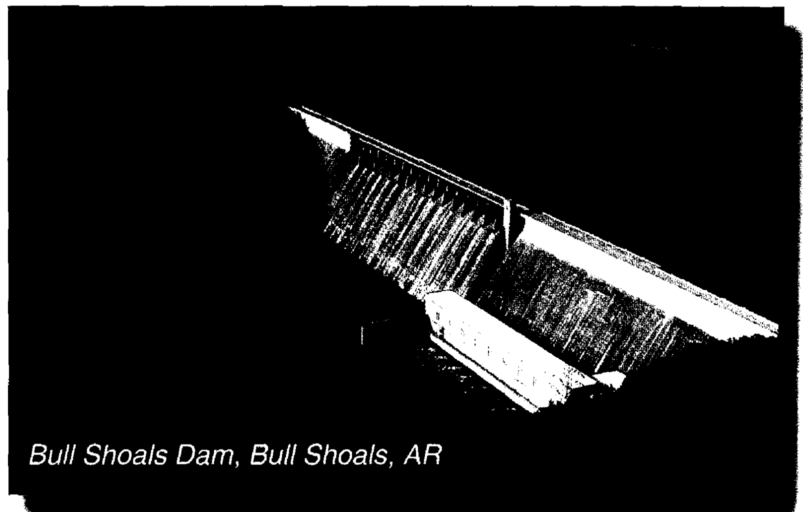
KEPCo completed a credit facility with CFC that allows KEPCo to fund the Iatan 2 project, including long-term, permanent financing, if required.

KEPCo negotiated a new long-term power supply agreement through 2018 with Sunflower Electric Cooperative which supplies approximately ten percent of KEPCo's energy requirements.

KEPCo finalized a three-year extension of its power supply contract with Southwestern Power Administration (SWPA), thru May 31, 2016.

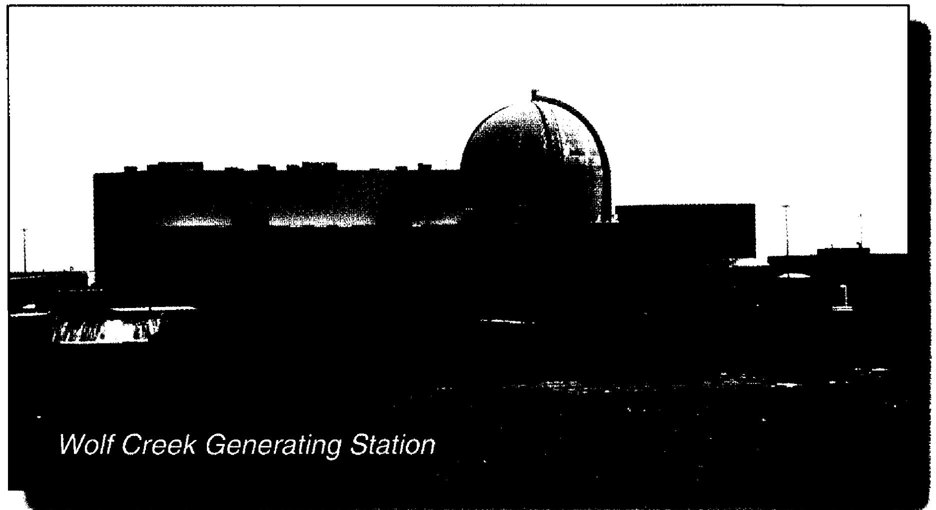
KEPCo executed documents to acquire a 30 MW ownership participation in Iatan 2, an 850 MW high-efficiency, coal-fired power plant

KEPCo participated in SWPA's 2006 energy deferral program to mitigate the severe drought conditions experienced in the region. Through this effort, KEPCo was able to continue to meet its Member power supply obligations with low-cost SWPA hydropower.



Bull Shoals Dam, Bull Shoals, AR

Wolf Creek Generating Station established a record-setting 506 days of continuous operation which culminated this fall with Refuel 15. The Refuel 15 outage was conducted in a record-setting 34 days.


Wolf Creek Generating Station

KEPCo continued to actively participate in the Southwest Power Pool (SPP) as the SPP progresses to develop as the regional transmission organization (RTO) in this area.

KEPCo assisted Members with customer parallel generation issues including the development of standardized customer parallel generation interconnection materials and holding workshops for Members.

Narrows Dam, Murfreesboro, AR

KEPCo's Long Range Resource Plan was updated. The update provides a strategic direction for KEPCo's power supply requirements for the next several years.

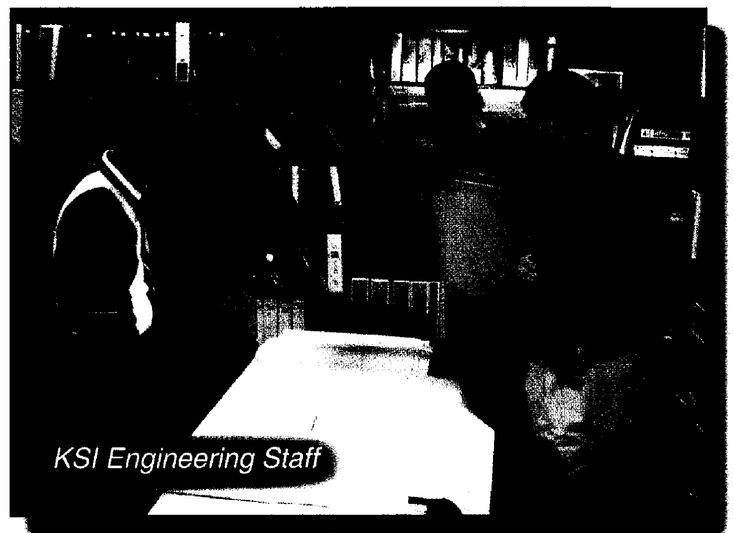
Wolf Creek Generating Station established a record-setting 506 days of continuous operation

The KEPCo Board of Trustees completed a two-day Strategic Planning Retreat in 2006. Developed from the retreat was a new Strategic Plan to guide KEPCo's business and power supply decisions in the future.

KEPCo's Sharpe Generating Station was available for peaking capacity the entire year and continues to be a valuable resource to KEPCo in addition to providing emergency back-up service for the Wolf Creek plant.

KEPCo Services, Inc. (KSI) recorded its ninth successful year of operation in 2006. KSI Engineering, the principal operating activity of KSI, is listed as the official engineering consultant by ten Electric Cooperatives. In 2006, KSI completed numerous challenging projects, including line staking for Members affected by damaging storms.

Continued on page 12


KSI Engineering Staff

KEPCo Member Cooperatives Trustees, Alternates and Managers

Dwight Engelland

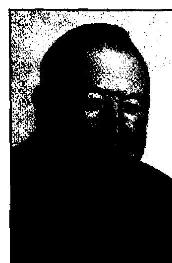
Ark Valley Electric Cooperative Assn., Inc.
PO Box 1246, Hutchinson, KS 67504
620-662-6661
Trustee Rep. -- Dwight Engelland
Alternate Trustee Rep. -- Bob Hall
Manager -- Bob Hall

Bob Hall

Ken Maginley

Bluestem Electric Cooperative, Inc.
PO Box 5, Wamego, KS 66547 785-456-2212
PO Box 513, Clay Center, KS 67432 785-632-3111
Trustee Rep. -- Kenneth J. Maginley
Alternate Trustee Rep. -- Robert M. Ohlde
Manager -- Kenneth J. Maginley

Bob Ohlde


Dale Bodenhausen

Brown-Atchison Electric Cooperative Assn., Inc.
PO Box 230, Horton, KS 66439 785-486-2117
Trustee Rep. -- Dale Bodenhausen
Alternate Trustee Rep. -- Kevin D. Compton
Manager -- Rodney V. Gerdes

Kevin Compton

Rod Gerdes

Richard Pearson

Butler Rural Electric Cooperative Assn., Inc.
PO Box 1242, El Dorado, KS 67042 316-321-9600
Trustee Rep. -- Richard Pearson
Alternate Trustee Rep. -- Dale Short
Manager -- Dale Short

Dale Short

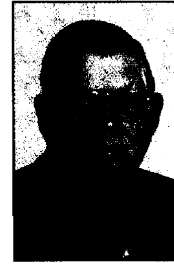
Dwane Kessinger

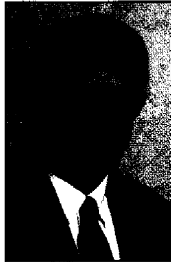
Caney Valley Electric Cooperative Assn., Inc.
PO Box 308, Cedar Vale, KS 67024 620-758-2262
Trustee Rep. -- Dwane Kessinger
Alternate Trustee Rep. -- Allen A. Zadorozny
Manager -- Allen A. Zadorozny

Allen Zadorozny

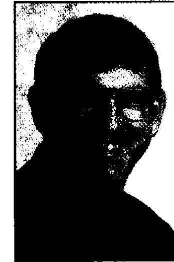
Kirk Thompson

CMS Electric Cooperative, Inc.
PO Box 790, Meade, KS 67864 620-873-2184
Trustee Rep. -- Kirk A. Thompson
Alternate Trustee Rep. -- Clifford Friesen
Manager -- Kirk A. Thompson


Cliff Friesen

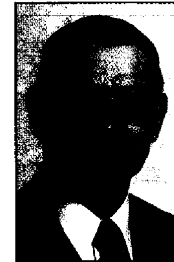

Harlow Haney

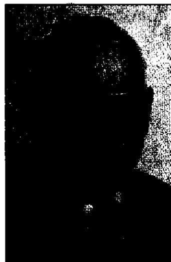
DS&O Rural Electric Cooperative Assn., Inc.
PO Box 286, Solomon, KS 67480 785-655-2011
Trustee Rep. -- Harlow L. Haney
Alternate Trustee Rep. -- Donald E. Hellwig
Manager -- Donald E. Hellwig


Don Hellwig

Bob Reece

Flint Hills Rural Electric Cooperative Assn., Inc.
PO Box B, Council Grove, KS 66846 620-767-5144
Trustee Rep. -- Robert E. Reece
Alternate Trustee Rep. -- Gus H. Hamm
Manager -- Robert E. Reece


Gus Hamm


Dennis Peckman

Heartland Rural Electric Cooperative, Inc.
PO Box 40, Girard, KS 66743 620-724-8251
District Offices, Iola 620-365-5151
Mound City, 913-795-2221
Trustee Rep. -- Dennis Peckman
Alternate Trustee Rep. -- Dale Coomes
Manager -- Dale Coomes

Dale Coomes

Larry Stevens

Leavenworth-Jefferson Electric Cooperative, Inc.
PO Box 70, McLouth, KS 66054 913-796-6111
Trustee Rep. -- Larry H. Stevens
Alternate Trustee Rep. -- H.B. Canida
Manager -- H.B. Canida

H.B Canida

Scott Whittington

Lyon-Coffey Electric Cooperative, Inc.
PO Box 229, Burlington, KS 66839 620-364-2116
Trustee Rep. -- Scott Whittington
Alternate Trustee Rep. -- Donna Williams
Manager -- Scott Whittington

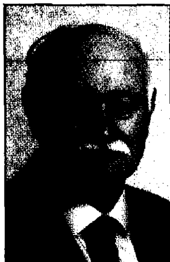
Donna Williams

KEPCo Member Cooperatives Trustees, Alternates and Managers

Gordon Coulter

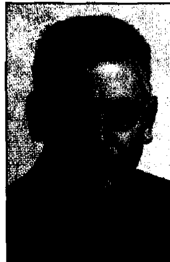
Ninnescah Electric Cooperative Assn., Inc.
PO Box 967, Pratt, KS 67124 620-672-5538
Trustee Rep. -- Gordon Coulter
Alternate Trustee Rep. -- Carla A. Bickel
Manager -- Carla A. Bickel

Carla Bickel

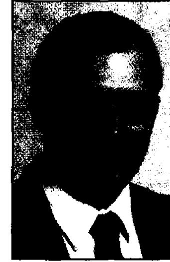

Gilbert Berland

Prairie Land Electric Cooperative, Inc.
PO Box 360, Norton, KS 67654 785-877-3323
District Office, Bird City 785-734-2311
Trustee Rep. -- Gilbert Berland
Alternate Trustee Rep. -- Allan J. Miller
Manager -- Allan J. Miller

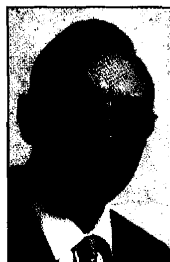
Allan Miller


Dennis Duft

Radiant Electric Cooperative, Inc.
PO Box 390, Fredonia, KS 66736 620-378-2161
Trustee Rep. -- Dennis Duft
Alternate Trustee Rep. -- Tom Ayers
Administrative Manager -- Leah Tindle
Operations Manager -- Dennis Duft


Tom Ayers

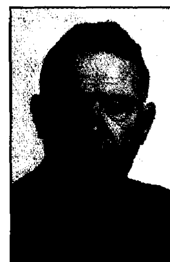
Leah Tindle


Melroy Kopsa

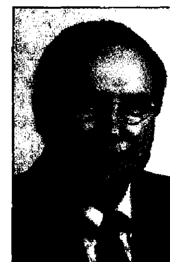
Rolling Hills Electric Cooperative, Inc.
PO Box 307, Mankato, KS 66956 785-378-3151
District Offices, Belleville 785-527-2251
Ellsworth 785-472-4021
Trustee Rep. -- Melroy Kopsa
Alternate Trustee Rep. -- Leon Eck
Manager -- Douglas J. Jackson

Leon Eck

Doug Jackson

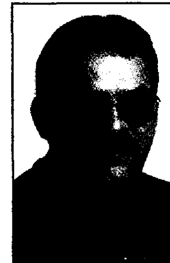

David Reichenberger

Sedgwick County Electric Cooperative Assn., Inc.
PO Box 220, Cheney, KS 67025 316-542-3131
Trustee Rep. -- David Reichenberger
Alternate Trustee Rep. -- Alan L. Henning
Manager -- Alan L. Henning


Alan Henning

Charles Riggs

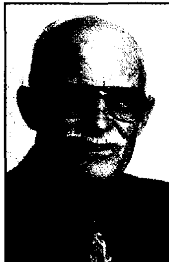
Sumner-Cowley Electric Cooperative, Inc.
PO Box 220, Wellington, KS 67152 620-326-3356
Trustee Rep. -- Charles Riggs
Alternate Trustee Rep. -- Cletas Rains
Manager -- Cletas Rains


Cletas Rains

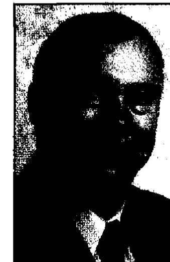
Bryan Coover

Twin Valley Electric Cooperative, Inc.
PO Box 385, Altamont, KS 67330 620-784-5500
Trustee Rep. -- Bryan W. Coover
Alternate Trustee Rep. -- Ron Holsteen
Manager -- Ron Holsteen

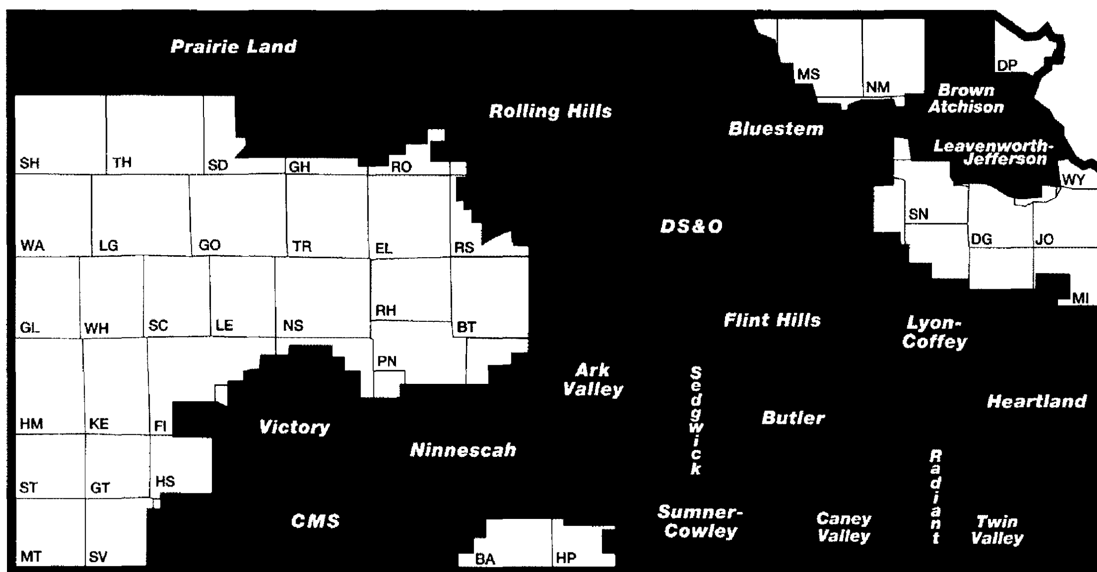
Ron Holsteen


Marvin Hampton

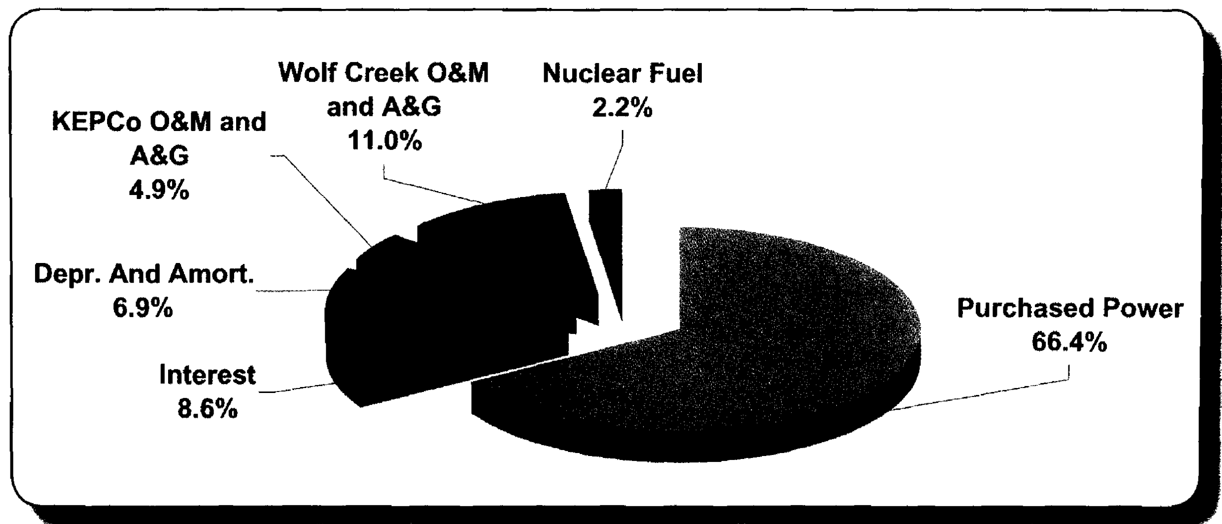
Victory Electric Cooperative Assn., Inc.
PO Box 1335, Dodge City, KS 67801 620-227-2139
Trustee Rep. -- Marvin Hampton
Alternate Trustee Rep. -- Terry Janson
Manager -- Terry Janson

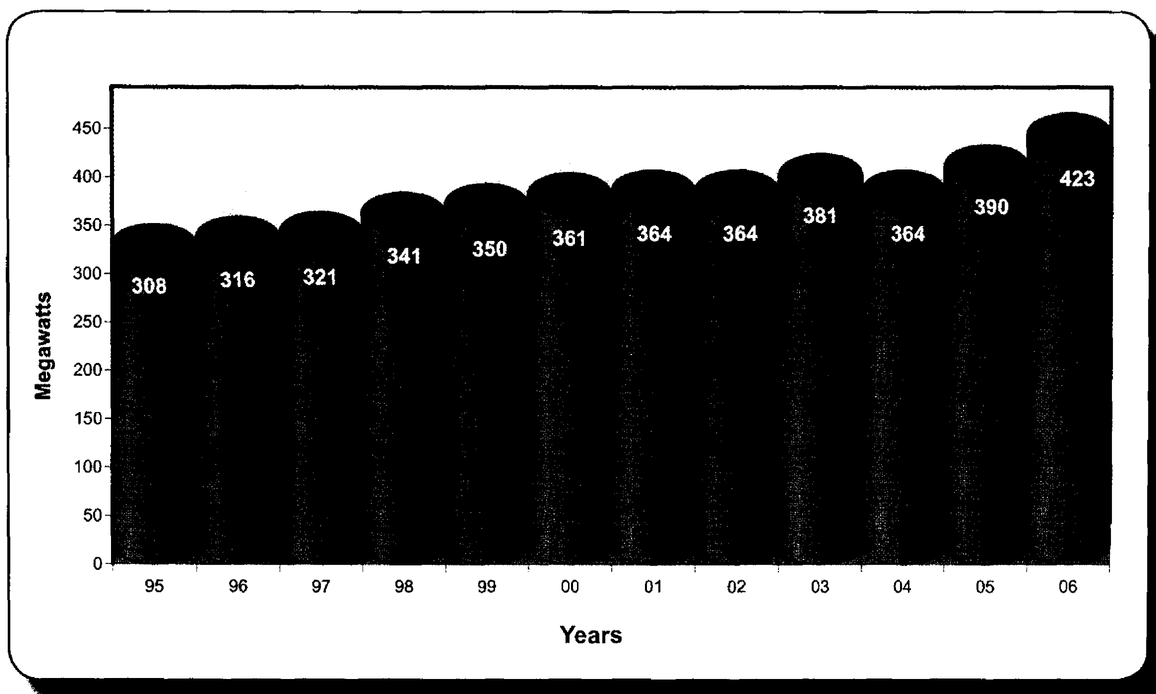

Terry Janson

KEPCo Member Area Map

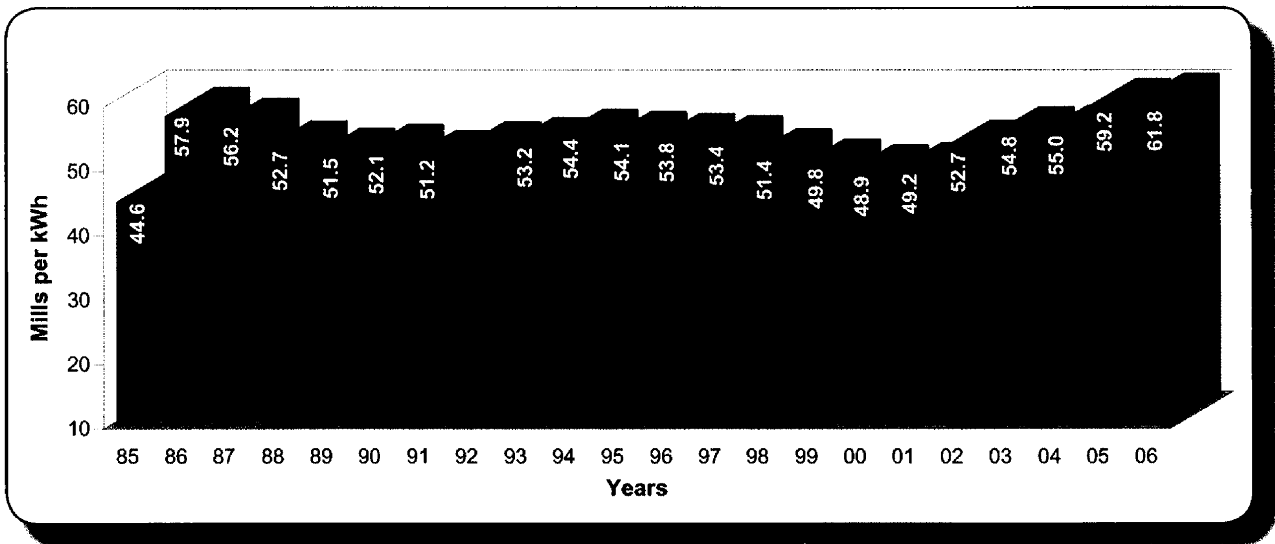


Operating Expenses



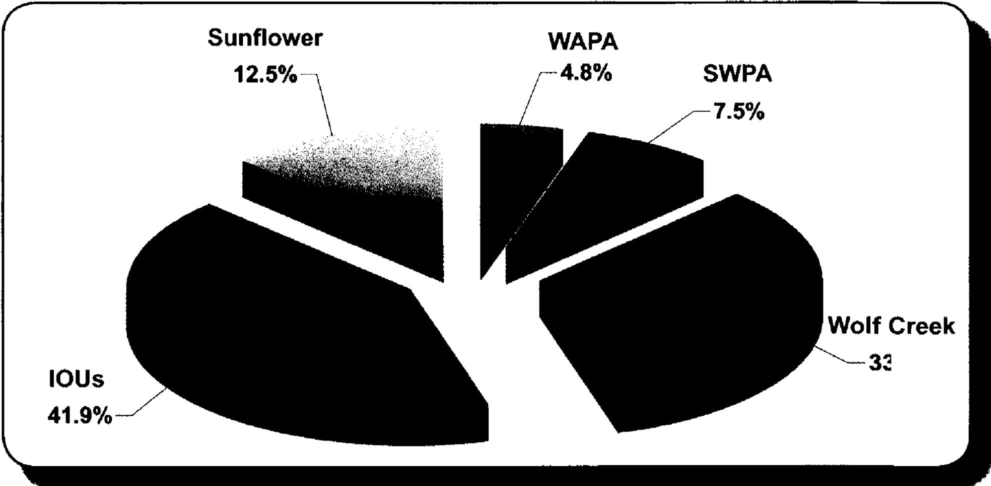


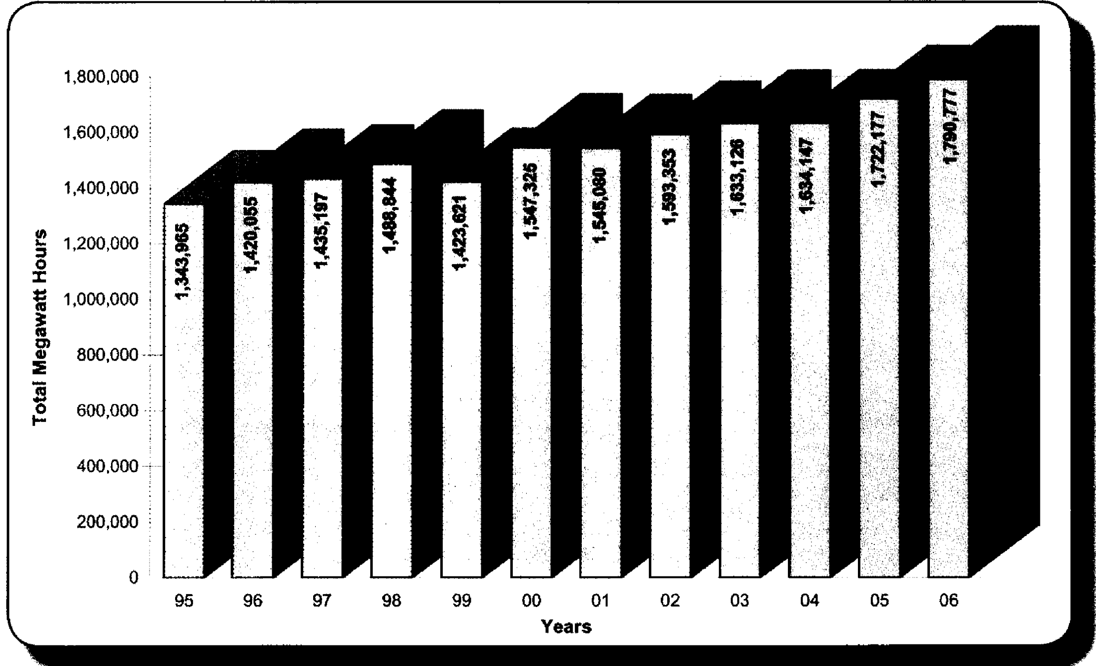
Peak Demand



Rates

Sources of Energy



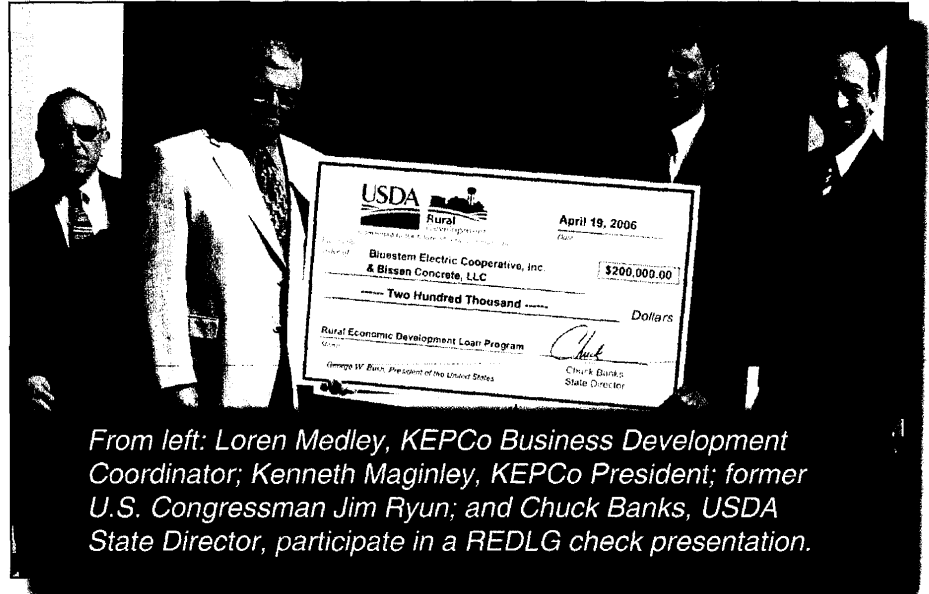


Energy Sales

2006 KEPCo Highlights

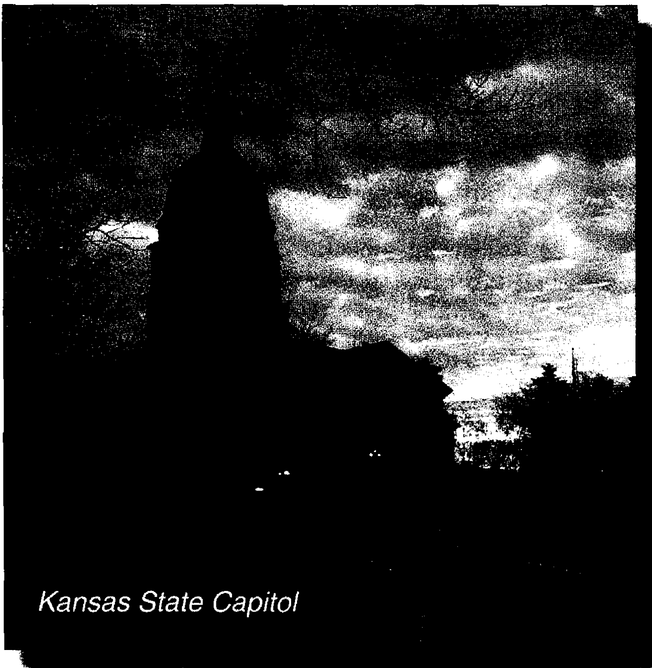
Continued from page 5

KEPCo continued to support Members in their successful participation in USDA's Rural Economic Development Loan and Grant (REDLG) program. In 2006, five Members garnered $2,196,000 in zero interest loans for a variety of economic development projects. An additional $2,247,102 was invested by the projects as supplemental funds for a total of $4,443,102 invested capital and the creation of 72 new rural area jobs in Kansas.



From left: Loren Medley, KEPCo Business Development Coordinator; Kenneth Maginley, KEPCo President; former U.S. Congressman Jim Ryun; and Chuck Banks, USDA State Director, participate in a REDLG check presentation.

KEPCo continues to work with KEC and Sunflower on legislative issues important to Kansas Cooperatives in Kansas and in Washington, D.C. KEPCo testified on several pieces of Kansas legislation in 2006 and tracked numerous other bills. KEPCo also participated in the NRECA Legislative Conference and supported a series of actions in response to NRECA calls for assistance on Federal legislation.



Kansas State Capitol

KEPCo continues to support Member marketing efforts by serving as a key contact for Touchstone Energy programs in Kansas, developing advertisements, helping with Member annual meetings and assisting on numerous individual Member projects.

KEPCo continued to fund and assist Members in promotion of an energy efficiency program targeted at electric water heaters and heating systems. KEPCo supports the efficient use of electricity and this program helps communicate that message.

KEPCo's support in economic development led to $4,443,102 invested capital and the creation of 72 new rural Kansas jobs during 2006

Independent Accountants' Report

Board of Trustees
Kansas Electric Power Cooperative, Inc.
Topeka, Kansas

We have audited the accompanying consolidated balance sheet of Kansas Electric Power Cooperative, Inc. (the Cooperative) as of December 31, 2006, and the related consolidated statements of margin, patronage capital and cash flows for the year then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Cooperative as of and for the year ended December 31, 2005, were audited by other accountants, whose report dated April 7, 2006, on those statements was qualified because certain depreciation and amortization methods used do not conform to accounting principles generally accepted in the United States of America as discussed in the notes.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As explained in *Note 3*, certain depreciation and amortization methods have been used in the preparation of the 2006 financial statements which, in our opinion, are not in accordance with accounting principles generally accepted in the United States of America. The effects on the financial statements of the aforementioned departure are explained in *Note 3*.

In our opinion, except for the effects of using the aforementioned depreciation and amortization methods as discussed in *Note 3*, the 2006 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we also have issued our report dated April 5, 2007, on our consideration of the Cooperative's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BKD LLP

April 5, 2007

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Consolidated Balance Sheets

December 31, 2006 and 2005

Assets	2006	2005
Utility Plant		
In-service	$ 225,003,755	$ 223,862,852
Less allowances for depreciation	(120,837,298)	(117,754,899)
Net in-service	104,166,457	106,107,953
Construction work in progress	6,550,342	2,278,799
Nuclear fuel, less accumulated amortization of $12,921,304 and $14,188,165 for 2006 and 2005, respectively	4,921,775	3,491,532
Total utility plant	115,638,574	111,878,284
Restricted Assets		
Investments in the National Rural Utilities Cooperative Finance Corporation	3,219,847	3,249,686
Bond fund reserve	4,295,806	4,262,478
Decommissioning fund	9,245,665	7,953,404
Investments in other associated organizations	152,306	142,514
Total restricted assets	16,913,624	15,608,082
Current Assets		
Cash and cash equivalents	3,271,471	5,345,163
Member accounts receivable	8,021,333	8,658,516
Materials and supplies inventory	2,983,476	2,827,387
Other assets and prepaid expenses	653,037	811,015
Total current assets	14,929,317	17,642,081
Other Long-term Assets		
Deferred charges		
Wolf Creek disallowed costs (less accumulated amortization of $11,120,734 and $10,363,570 for 2006 and 2005, respectively)	14,862,187	15,619,350
Wolf Creek deferred plants costs (less accumulated amortization of $15,649,598 and $12,519,678 for 2006 and 2005, respectively)	31,299,195	34,429,115
Wolf Creek decommissioning regulatory asset	4,114,385	3,159,210
Deferred Department of Energy decommissioning costs	74,712	167,915
Deferred incremental outage costs	3,535,349	2,015,086
Other deferred charges (less accumulated amortization of $6,106,253 and $5,405,117 for 2006 and 2005, respectively)	3,597,661	4,298,796
Unamortized debt issuance costs	855,402	980,834
Other investments	248,686	210,958
Total long-term assets	58,587,577	60,881,264
Total assets	$ 206,069,092	$ 206,009,711

Consolidated Balance Sheets

December 31, 2006 and 2005

Liabilities and Patronage Capital	2006	2005
Patronage Capital		
Memberships	$ 3,200	$ 3,200
Patronage capital	19,497,487	18,450,805
Total patronage capital	19,500,687	18,454,005
Long-term Debt	142,272,490	149,908,644
Other Long-term Liabilities		
Wolf Creek decommissioning liability	16,332,466	13,916,214
Wolf Creek nuclear operating liabilities	2,589,872	2,443,767
Arbitrage rebate long-term liability	537,765	992,862
Other deferred credits	12,452	100,213
Total other long-term liabilities	19,472,555	17,453,056
Current Liabilities		
Current maturities of long-term debt	11,162,495	10,464,348
Line of credit	3,521,028	—
Accounts payable	7,958,739	7,750,203
Payroll and payroll-related liabilities	284,661	263,690
Accrued property taxes	1,319,875	1,294,342
Accrued interest payable	576,562	421,423
Total current liabilities	24,823,360	20,194,006
Total patronage capital and liabilities	$ 206,069,092	$ 206,009,711

See accompanying notes to consolidated financial statements.

Statements of Revenue and Expenses

December 31, 2006 and 2005

	2006	2005
Operating Revenues		
Sales of electric energy	$ 110,707,844	$ 101,933,017
Other	64,089	318,689
Total operating revenues	110,771,933	102,251,706
Operating Expenses		
Power purchased	73,351,849	63,050,719
Nuclear fuel	2,382,257	2,281,038
Plant operations	9,072,478	8,731,121
Plant maintenance	3,062,210	2,974,581
Administrative and general	5,069,698	4,901,614
Amortization of deferred charges	4,588,219	5,142,698
Depreciation and decommissioning	4,168,565	4,362,753
Total operating expenses	101,695,276	91,444,524
Net operating revenues	9,076,657	10,807,182
Interest and Other Deductions		
Interest on long-term debt	8,540,243	8,836,180
Amortization of debt issuance costs	125,431	129,895
Other deductions	172,704	67,315
Total interest and other deductions	8,838,378	9,033,390
Operating Income	238,279	1,773,792
Other Income (Expense)		
Interest income	875,646	853,209
Other income (expense)	(67,243)	824,856
Total other income	808,403	1,678,065
Net margin	$ 1,046,682	$ 3,451,857

See accompanying notes to consolidated financial statements.

Statements of Changes in Patronage Capital

December 31, 2006 and 2005

	Memberships	Patronage Capital	Total
Balance, December 31, 2004	$ 3,200	$ 14,998,948	$ 15,002,148
Net margin	—	3,451,857	3,451,857
Balance, December 31, 2005	3,200	18,450,805	18,454,005
Net margin	—	1,046,682	1,046,682
Balance, December 31, 2006	$ 3,200	$ 19,497,487	$ 19,500,687

Statements of Cash Flows

December 31, 2006 and 2005

	2006	2005
Operating Activities		
Net margins	$ 1,046,682	$ 3,451,857
Adjustments to reconcile net margin to net cash provided by operating activities		
Depreciation and amortization	3,704,711	3,911,449
Decommissioning	1,458,328	451,304
Amortization of nuclear fuel	1,748,780	1,681,987
Amortization of deferred charges	4,588,218	4,045,720
Amortization of deferred incremental outage costs	2,557,796	3,470,606
Amortization of debt issuance costs	125,432	129,895
Changes in		
Member accounts receivable	637,183	(1,326,340)
Materials and supplies	(156,089)	(42,261)
Other assets and prepaid expenses	120,250	(202,794)
Accounts payable	208,536	284,122
Payroll and payroll-related liabilities	20,971	(2,444)
Accrued property tax	25,533	(16,441)
Accrued interest payable	155,139	51,333
Restricted assets	(33,328)	(49,836)
Other long-term liabilities	(300,801)	249,471
Net cash provided by operating activities	15,907,341	16,087,628
Cash Flows From Investing Activities		
Additions to electric plant	(6,034,758)	(1,469,394)
Additions to nuclear fuel	(3,179,023)	(615,088)
Additions to deferred incremental outage costs	(4,078,059)	(3,556,885)
Investments in decommissioning fund assets	(1,292,261)	(451,304)
Other	20,047	—
Net cash used in investing activities	(14,564,054)	(6,092,671)
Cash Flows From Financing Activities		
Net borrowing under line of credit agreement	3,521,028	—
Principle payments on long-term debt	(10,464,348)	(9,907,800)
Increase in debt issuance costs related to debt refinancing	—	(670,489)
Utilization of RUS cushion of credit	3,526,341	698,771
Net cash used in financing activities	(3,416,979)	(9,879,518)
Net increase (decrease) in cash and cash equivalents	(2,073,692)	115,439
Cash and Cash Equivalents, Beginning of Year	5,345,163	5,229,724
Cash and Cash Equivalents, End of Year	$ 3,271,471	$ 5,345,163
Supplemental Cash Flows Information		
Cash paid during the year for interest	$ 8,385,104	$ 8,852,162

See accompanying notes to consolidated financial statements.

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Kansas Electric Power Cooperative, Inc. and its subsidiary (KEPCo), headquartered in Topeka, Kansas, was incorporated in 1975 as a not-for-profit generation and transmission cooperative (G&T). KEPCo is under the jurisdiction of the Kansas Corporation Commission (KCC) and was granted a limited certificate of convenience and authority in 1980 to act as a G&T public utility. It is KEPCo's responsibility to procure an adequate and reliable power supply for its 19 distribution rural electric cooperative members pursuant to all requirements of its power supply contracts. KEPCo is governed by a board of trustees representing each of its 19 members, which collectively serve more than 100,000 electric customers in rural Kansas.

System of Accounts

KEPCo maintains its accounting records substantially in accordance with the Rural Utilities Service (RUS) Uniform Systems of Accounts and in accordance with accounting practices prescribed by the KCC.

Rates

The KCC has the authority to establish KEPCo's electric rates under state law in Kansas. Rates are established to meet the times-interest-earned ratio and debt-service coverage set forth by the RUS. KEPCo's rates include an energy cost adjustment (ECA) mechanism, which allows KEPCo to pass along increases in certain energy costs to its cooperative members.

Principles of Consolidation

The consolidated financial statements include the amounts of the Cooperative and its majority-owned subsidiary, KEPCo Services, Inc. Undivided interests in jointly owned generation facilities are consolidated on a pro rata basis. All material intercompany accounts and transactions have been eliminated in consolidation.

Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Utility Plant and Depreciation

Utility plant is stated at cost. The cost of repairs and minor replacements are charged to operating expenses as appropriate. Costs of renewals and betterments are capitalized. The original cost of utility plant retired and the cost of removal, less salvage, are charged to accumulated depreciation.

The composite depreciation rate for electric generation plant for the years ended December 31, 2006 and 2005, was 2.98% and 2.98%, respectively.

The provision for depreciation computed on a straight-line basis for electric and other components of utility plant is as follows:

Transportation and equipment	25 to 33 years
Office furniture and fixtures	10 to 20 years
Leasehold improvements	20 years
Transmission equipment	10 years

Nuclear Fuel

The cost of nuclear fuel in process of refinement, conversion, enrichment and fabrication is recorded as utility plant asset at original cost and is amortized to nuclear fuel expenses based upon the quantity of heat produced

for the generation of electric power. The permanent disposal of spent fuel is the responsibility of the Department of Energy (DOE). KEPCo pays one cent per net MWh of nuclear generation to the DOE for the future disposal service. These disposal costs are charged to nuclear fuel expense.

Decommissioning Fund Assets/Decommissioning Liability

As of December 31, 2006 and 2005, approximately $9.2 million and $8 million, respectively, have been collected and are being retained in an interest-bearing trust fund to be used for the physical decommissioning of Wolf Creek Nuclear Generating Station (Wolf Creek). The trustee invests the decommissioning funds primarily in mutual finds, which are carried at estimated fair value. During 2003, the KCC extended the estimated useful life of Wolf Creek to 60 years from the original estimates of 40 years only for the determination of decommissioning costs to be recognized for ratemaking purposes. In 2006, the KCC approved a 2005 decommissioning cost study, which increased the estimate of total decommissioning costs to $517.6 million in 2005 dollars ($31.1 million is KEPCo's share). The study assumes a 4.4% rate of inflation and 7% rate of return.

KEPCo adopted the Statement of Financial Accounting Standard (SFAS) No. 143, Accounting for Asset Retirement Obligations, on January 1, 2003. SFAS No. 143 provides accounting requirements for the recognition and measurement of liabilities associated with the retirement of tangible long-lived assets. Under the standard, these liabilities will be recognized at fair value as incurred and capitalized and depreciated over the appropriate period as part of the cost of the related tangible long-lived assets.

SFAS No. 143 required KEPCo to recognize and estimate the liability for its 6% share of the estimated cost to decommission Wolf Creek, based on the present value of the asset retirement obligation KEPCo incurred at the time it was placed into service in 1985. On January 1, 2003, KEPCo initially recognized an asset retirement obligation of $11.7 million; utility plant in-service, net of accumulated depreciation, was increased by $2.9 million; and KEPCo also established a regulatory asset for $3.9 million, which represents the amount of the Wolf Creek asset retirement obligation and accumulated depreciation not yet refunded.

The decommissioning study in 2005 increased the asset retirement obligation by approximately $1.5 million, utility plant in-service, net of accumulated depreciation by $.2 million and the regulatory asset by $1.2 million in 2006.

A reconciliation of the asset retirement obligation for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005
Balance at January 1	$ 13,916,214	$ 13,128,504
Accretion	938,420	787,710
Increase from 2005 study	1,477,832	—
Balance at December 31	$ 16,332,466	$ 13,916,214

Any net margin effects are deferred in the Wolf Creek decommissioning regulatory asset created pursuant to SFAS No. 71, Accounting for the Effects of Certain types of Regulation, and will be collected from members in future electric rates.

Cash and Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents and are stated at cost, which approximates fair value. Cash equivalents consist primarily of certificates of deposit.

Accounts Receivable

Accounts receivable are stated at the amount billed to members and customers. The Cooperative provides allowances for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Materials and Supplies Inventory

Materials and supplies inventory are valued at average cost.

Unamortized Debt Issuance Costs

Unamortized debt issue costs relate to the issuance of the floating/fixed rate pollution control revenue bonds, mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC) trusts, and fees for repricing the Federal Financing Bank (FFB) debt. These costs are being amortized using the effective interest method over the remaining life of the bonds and notes.

Cash Surrender Value of Life Insurance Contracts

The following amounts related to Wolf Creek Nuclear Operating Corporation (WCNOC) corporate-owned life insurance contracts, primarily with one highly rated major insurance company, are included in other investments on the consolidated balance sheets.

	2006	2005
Cash surrender value of contracts	$ 4,693,922	$ 4,383,449
Borrowings against contracts	(4,693,922)	(4,383,449)
	$ 0	$ 0

Borrowings against contracts include a prepaid interest charge. KEPCo pays interest on these borrowings at a rate of 4.27% and 5.45% for the years ended December 31, 2006 and 2005, respectively.

Revenues

Revenues are recognized during the month the electricity is sold. Revenues from the sale of electricity are recorded based on usage by member cooperatives and customers and on contracts and scheduled power usages as appropriate.

Income Taxes

As a tax-exempt cooperative, KEPCo is exempt from income taxes under Section 501(c)(12) of the Internal Revenue Code of 1986, as amended. Accordingly, provisions for income taxes have not been reflected in the accompanying consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 financial statement presentation. These reclassifications had no effect on net earnings.

Note 2: Factors That Could Affect Future Operating Results

KEPCo currently applies accounting standards that recognize the economic effects of rate regulation pursuant to SFAS No. 71, *Accounting for the Effect of Certain Types of Regulation*, and accordingly has recorded regulatory assets and liabilities related to its generation and transmission operations. In the event KEPCo determines that it no longer meets the criteria of SFAS No. 71, the accounting impact could be a noncash charge to operations of an amount that would be material. Criteria that could give rise to the discontinuance of SFAS No. 71 include: (1) increasing competition that restricts KEPCo's ability to establish prices to recover specific costs, and (2) a significant change in the manner rates are set by regulators from a cost-based regulation to

another form of regulation. KEPCo periodically reviews these criteria to ensure the continuing application of SFAS No. 71 is appropriate. Any changes that would require KEPCo to discontinue the application of SFAS No. 71 due to increased competition, regulatory changes or other events may significantly impact the valuation of KPECo's investment in utility plant, its investment in Wolf Creek and necessitate the write-off of regulatory assets. At this time, the effect of competition and the amount of regulatory assets that could be recovered in such an environment cannot be predicted.

The 1992 Energy Policy Act began the process of restructuring the United States electric utility industry by permitting the Federal Energy Regulatory Commission to order electric utilities to allow third parties to sell electric power to wholesale customers over their transmission systems. The Kansas legislature has not taken any significant action on industry restructuring that would have a direct impact on KEPCo. Management will continue to monitor deregulation initiatives, but does not presently expect any actions that would be unfavorable to KEPCo to be adopted within the next 12 months.

Note 3: Departures From Generally Accepted Accounting Principles

Effective February 1, 1987, the KCC issued an order to KEPCo requiring the use of present worth (sinking fund) depreciation and amortization. As more fully described in Note 7, such depreciation and amortization methods constituted phase-in plans that did not meet the requirements of SFAS No. 92, Accounting for Phase-In Plans.

Effective February 1, 2002, the KCC issued an order that extended the depreciable life of Wolf Creek from 40 years to 60 years. This order also permitted recovery in rates of the $53.5 million cumulative difference between historical present worth (sinking fund) depreciation and amortization and straight-line depreciation and amortization of Wolf Creek generation plant and disallowed costs over a 15-year period. As more fully described in Note 7, such depreciation and amortization methods constitute phase-in plans that do not meet the requirements of SFAS No. 92. Recovery of these costs in rates is included in operating revenues, and the related amortization expense is included in deferred charges in the consolidated statements of revenues and expenses. Investment gains related to the decommissioning fund are recorded as a reduction to the regulatory asset. KEPCo recorded gains of $0.9 million and $0.8 million in 2006 and 2005, respectively.

The effect of these departures from generally accepted accounting principles is to overstate (understate) the following items in the consolidated financial statements by the following amounts:

	2006	2005
Deferred charges	$ 35,636,341	$ 39,199,975
Patronage capital	35,636,341	39,199,975
Net margin	(3,563,634)	(3,563,634)

Note 4: Wolf Creek Nuclear Operating Corporation (WCNOC)

KEPCo owns 6% of WCNOC, which is located near Burlington, Kansas. The remainder is owned by the Kansas City Power & Light Company (KCPL–47%) and Kansas Gas & Electric Company (KGE–47%). KGE is a wholly owned subsidiary of Westar Energy, Inc. KCPL is a wholly owned subsidiary of Great Plains Energy, Inc. KEPCo's undivided interest in WCNOC is consolidated on a pro rata basis. Substantially all of KEPCo's utility plant consists of its pro rata share of WCNOC. KEPCo is entitled to a proportionate share of the capacity and energy from WCNOC, which is used to supplement a portion of KEPCo's members' requirements. KEPCo is billed on a daily basis for 6% of the operations, maintenance, administrative and general costs and cost of plant additions related to WCNOC.

WCNOC disposes of all classes of its low-level radioactive waste at existing third-party repositories. Should disposal capability become unavailable, WCNOC is able to store its low-level radioactive waste in an on-site facility for up to five years under current regulations.

The Low-Level Radioactive Waste Policy Amendments Act of 1985 mandated that the various states, individually or through interstate compacts, develop alternative low-level radioactive waste disposal facilities. The states of Kansas, Nebraska, Arkansas, Louisiana and Oklahoma formed the Central Interstate Low-Level Radioactive Waste Compact (Compact) and the Compact Commission, which is responsible for causing a new disposal facility to be developed within one of the member states. The Compact Commission selected Nebraska as the host state for the disposal facility. WCNOC and the owners of the five other nuclear units in the Compact provided most of the preconstruction financing for this project.

In December 1998, the Nebraska agencies responsible for considering the developer's license application denied the application. Most of the utilities that had provided the project's preconstruction financing, including the WCNOC, as well as the Compact Commission itself, filed a lawsuit in federal court contending that Nebraska officials acted in bad faith while handling the license application. In September 2002, the court entered a judgment of $151.4 million, about one-third of which constitutes prejudgment interest, in favor of the Compact Commission and against Nebraska, finding that Nebraska had acted in bad faith in handling the license application. In August 2004, Nebraska and the Compact Commission settled this case. In August 2005, WCNOC received $19.6 million ($1.2 million is KEPCo's share) in proceeds from the Compact as a result of the settlement. In 2006, KEPCo received $0.1 million of interest income from the Compact.

Note 5: Investments in Associated Organizations

Investments in associated organizations are carried at cost. At December 31, 2006 and 2005, investments in associated organizations consisted of the following:

	2006	2005
CFC		
Memberships	$ 1,000	$ 1,000
Capital term certificates	395,970	395,970
Subordinated term certificates	2,205,000	2,205,000
Patronage capital certificates	25,134	16,566
Equity term certificates	592,743	631,150
	3,219,847	3,249,686
Other	152,306	142,514
	$ 3,372,153	$ 3,392,200

Note 6: Bond Fund Reserve

KEPCo has entered into a bond covenant whereby KEPCo is required to maintain, with a trustee, a bond fund reserve of approximately $4.3 million. This stipulated amount is sufficient to satisfy certain future interest and principal obligations. The amount held in the bond fund reserve is invested by the trustee in tax-exempt municipal securities, pursuant to the restrictions of the indenture agreement, which are carried at amortized cost.

Note 7: Deferred Charges

Disallowed Costs

Effective October 1, 1985, the KCC issued a rate order relating to KEPCo's investment in Wolf Creek, which

disallowed $26.0 million of KEPCo's investment in Wolf Creek ($14.9 net of accumulated amortization as of December 31, 2006). A subsequent rate order, effective February 1, 1987, allows KEPCo to recover these disallowed costs and other costs related to the disallowed portion (recorded as deferred charges) for the period from September 3, 1985 through January 31, 1987, over a 27.736-year period starting February 1, 1987. Pursuant to a KCC rate order dated December 30, 1998, the disallowed portion's recovery period was extended to a 30-year period. Through December 31, 2001, KEPCo used the present worth (sinking fund) method to recover the disallowed costs, which enabled it to meet the times-interest-earned ratio and debt service requirements in the KCC rate order dated January 30, 1987. The method used by KEPCo through 2001 constituted a phase-in plan that did not meet the requirements of Statement of Financial Accounting Standard No. 92, Accounting for Phase-In Plans (SFAS No. 92).

Effective February 1, 2002, the KCC issued an order permitting recovery in rates of the $6.5 million cumulative difference between historical present worth (sinking fund) and straight-line amortization of Wolf Creek disallowed costs over a 15-year period. Such depreciation practice does not constitute a phase-in plan that meets the requirements of SFAS No. 92.

If the disallowed costs were recovered using a method in accordance with accounting principles generally accepted in the United States, the costs would have been expensed in their entirety upon implementation of the KCC order, with a corresponding decrease in patronage capital.

Wolf Creek Deferred Plant Costs

Effective February 1, 2002, the KCC issued an order permitting recovery in rates of the $46.9 million cumulative difference between historical present worth (sinking fund) depreciation and straight-line depreciation of Wolf Creek generation plant over a 15-year period. Such depreciation practice does not constitute a phase-in plan that meets the requirements of SFAS No. 92. In 2002, this cumulative difference was reclassified from utility plant allowance for depreciation to deferred charges on the consolidated balance sheets to reflect the amount as a regulatory asset. Amortization of the Wolf Creek deferred plant costs is included in amortization of deferred charges and amounts to $3.1 million for each of the years ended December 31, 2006 and 2005.

If the deferred plant costs were recovered using a method in accordance with accounting principles generally accepted in the United States, the costs would have been expensed in their entirety upon implementation of the KCC order, with a corresponding decrease in patronage capital.

Deferred Incremental Outage Costs

In 1991, the KCC issued an order that allowed KEPCo to defer its 6% share of the incremental operating, maintenance and replacement power costs associated with the periodic refueling of Wolf Creek. Such costs are deferred during each refueling outage and are being amortized over the approximate 18-month operating cycle coincident with the recognition of the related revenues. Additions to the deferred incremental outage costs were $4.1 million and $3.6 million in 2006 and 2005, respectively. The current year amortization of the deferred incremental outage costs was $2.6 million and $2.3 million in 2006 and 2005, respectively.

Other Deferred Charges

KEPCo includes in other deferred charges the early call premium resulting from refinancings. These early call premiums are amortized using the effective interest method over the remaining life of the new agreements.

Note 8: Short-Term Borrowings

As of December 31, 2005, KEPCo has a $15 million line of credit outstanding with the CFC. This line of credit has a term of 24 months. There were outstanding borrowings of $3,521,028 and $0 at December 31, 2006, and December 31, 2005, respectively. Interest varies and was 7.15% at December 31, 2006.

Note 9: Long-Term Debt

Long-term debt consists of mortgage notes payable to the United States of America acting through the FFB, the CFC and others. Substantially all of KEPCo's assets are pledged as collateral. The terms of the notes as of December 31 are as follows:

	2006	2005
Mortgage notes payable to the FFB at fixed rates varying from 3.616% to 9.206%, payable in quarterly installments through 2018*	$ 79,232,070	$ 81,792,204
Mortgage notes payable to the Grantor Trust Series 1997 at a rate of 7.522%, payable semiannually, principle payments commencing in 1999 and continuing annually through 2017	43,340,000	45,640,000
Floating/fixed rate pollution control revenue bonds, City of Burlington, Kansas, Pooled Series 1985C, variable interest rate (ranging from 3.53% to 3.64% at December 31, 2006) payable annually through 2015	26,700,000	28,500,000
Mortgage note payable and equity certificate loan to the National Rural Utilities Cooperative Finance Corporation at fixed rates of 5.95%, payable quarterly through 2017	4,162,915	4,440,788
	153,434,985	160,372,992
Less current maturities	11,162,495	10,464,348
	$ 142,272,490	$ 149,908,644

* The mortgage notes payable to FFB are presented net of $0 and $3,526,341 of cash deposited with the RUS for the future repayment of debt as of December 31, 2006 and 2005, respectively. These deposits are restricted for the future repayment of FFB debt and earn interest at a rate of 5%.

Aggregate maturities of long-term debt for the next five years and thereafter are as follows:

2007	$ 11,162,495
2008	11,950,139
2009	12,771,958
2010	13,689,904
2011	14,766,747
Thereafter	89,093,742
	$ 153,434,985

Restrictive covenants require KEPCo to design rates that would enable it to maintain a times-interest-earned ratio of at least one-to-one and debt-service coverage of at least one-to-one, on average, in at least two out of every three years. The covenants also prohibit distribution of net patronage capital or margins until, after giving effect to any such distribution, total patronage capital equals or exceeds 20% of total assets, unless such distribution is approved by RUS. KEPCo was in compliance with such restrictive covenants as of December 31, 2006 and 2005.

In 1997, KEPCo refinanced its mortgage notes payable to the 1988 CFC Grantor Trust through the establish-

ment of a new CFC Grantor Trust Series 1997 (the Series 1997 Trust) by CFC. This refinancing reduced the guaranteed interest rate payable on the mortgage notes to a fixed rate of 7.522% through the use of an interest rate swap that was assigned by KEPCo to the Series 1997 Trust. The mortgage notes payable are prepayable at any time with no prepayment penalties. However, any termination costs relating to the termination of the assigned interest rate swaps is KEPCo's responsibility. At December 31, 2006, the termination obligation associated with the assigned swap agreement to early retire the mortgage notes payable is approximately $6.4 million. This fair value estimate is based on information available at December 31, 2006, and is expected to fluctuate in the future based on changes in interest rates and outstanding principal balance.

KEPCo also is exposed to possible credit loss in the event of noncompliance by the counterparty to the swap agreement. However, KEPCo does not anticipate nonperformance by the counterparty.

Note 10: Benefit Plans

National Rural Electric Cooperative Association (NRECA) Retirement and Security Program

KEPCo participates in the NRECA Retirement and Security Program for its employees. All employees are eligible to participate in this program after one year of service. In the master multi-employer plan, which is available to all members of NRECA, the accumulated benefits and plan assets are not determined or allocated by individual employees. KEPCo's expense under this program was $0.2 million for each of the years ended December 31, 2006 and 2005.

NRECA Savings 401(k) Plan

All employees of KEPCo are eligible to participate in the NRECA Savings 401(k) Plan. Under the plan, KEPCo contributes an amount not to exceed 5%, dependent upon each employee's level of participation and completion of one year of service, of the respective employee's base pay to provide additional retirement benefits. KEPCo contributed $0.1 million to the plan for each of the years ended December 31, 2006 and 2005.

WCNOC Retirement Plans

KEPCo has an obligation to the WCNOC retirement and supplemental retirement plans for its 6% ownership interest in Wolf Creek. The plans provide for benefits upon retirement, normally at age 65. In accordance with the Employee Retirement Income Security Act of 1974, KEPCo has satisfied its minimum funding requirements. Benefits under the plans reflect the employee's compensation, years of service and age at retirement.

Wolf Creek uses a measurement date of December 1 for its retirement plan and January 1 for its supplemental retirement plan.

The following sets forth KEPCo's share of the plans' changes in benefit obligation, plan assets and funded status as of December 31:

	2006	2005
Changes in benefit obligation		
Benefit obligation at beginning of year	$ 9,132,420	$ 7,553,340
Service cost	414,240	359,940
Interest cost	548,040	476,160
Actuarial loss	168,840	869,580
Benefits paid	(151,320)	(126,600)
Benefit obligation at end of year	$ 10,112,220	$ 9,132,420
Accumulated benefit obligation	$ 7,958,220	$ 7,059,780

Plan assets are invested in insurance contracts, corporate bonds, equity securities, United States government securities and short-term investments.

	2006	2005
Changes in plan assets		
Fair value of plan assets at beginning of year	$ 5,074,740	$ 4,147,800
Actual return on plan assets	554,760	380,280
Contributions during the year	608,460	649,020
Benefits paid	(127,080)	(102,360)
Fair value of plan assets at end of year	$ 6,110,880	$ 5,074,740
Funded status	(4,001,340)	(4,057,680)
Unrecognized net actuarial loss	2,498,520	2,661,660
Unrecognized prior service cost	—	24,060
Unrecognized net transition obligation	—	43,560
Postmeasurement date adjustments	148,560	26,220
Accrued benefit cost	$ (1,354,260)	$ (1,302,180)
Actuarial assumptions used to determine benefit obligations		
Discount rate	5.70%	5.75%
Annual salary increase rate	3.25%	3.25%

The asset allocation for the plans at the end of 2006 and 2005, and the target allocation for 2006 by asset category are as follows:

	Target Allocation for 2006	Plan Assets 2006	Plan Assets 2005
Asset category			
Equity securities	65%	63%	65%
Debt securities	35%	34	29
Other	0–5%	3	6
		100%	100%

WCNOC's pension plan investment strategy supports the objective fund, which is to earn the highest possible return on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors and manager style to minimize the risk of large losses. WCNOC delegates investment management to specialists in each asset class and, where appropriate, provides the investment manager with specific guidelines, which include allowable and/or prohibited investment types. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews.

KEPCo's share of the net periodic pension costs were as follows for the years ended December 31:

	2006	2005
Service cost	$ 414,240	$ 359,940
Interest cost on projected benefit obligation	548,040	476,160
Expected return on plan assets	(437,580)	(397,560)
Amortization of actuarial loss	231,420	171,060
Other	11,280	11,280
Total net periodic pension cost	$ 767,400	$ 620,880
Actuarial assumptions used to determine net periodic pension cost		
Discount rate	5.75%	6.00%
Expected return on plan assets	8.25%	8.75%
Annual salary increase rate	3.25%	3.00%

The expected return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans' investment portfolio. Assumed projected rates of return for each asset class were selected after analyzing long-term historical experience and future expectation of the volatility of the various asset classes. Based on the target asset allocations for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets. In selecting the discount rate, fixed income security yield rates for corporate high-grade bond yields were considered.

KEPCo estimates cash contributions of $0.8 million will be made to the plans in 2007.

Estimated future benefit payments for the plans, which reflect expected future services, are as follows:

2007	$ 156,000
2008	186,000
2009	216,000
2010	258,000
2011	306,000
Thereafter	2,574,000
	$ 3,696,000

Wolf Creek Nuclear Operating Corporation (WCNOC) Postretirement Benefits

KEPCo has an obligation to the WCNOC postretirement plan for its 6% ownership interest in Wolf Creek. This plan provides certain medical benefits to participants upon retirement. KEPCo's 6% obligation is presented in Wolf Creek nuclear operating liabilities in the accompanying consolidated balance sheets and was $0.6 million and $0.5 million as of December 31, 2006 and 2005, respectively.

Note 11: Commitments and Contingencies

Litigation

There is a provision in the Wolf Creek operating agreement whereby the owners treat certain claims and losses arising out of the operation of Wolf Creek as a cost to be borne by the owners separately (but not jointly) in proportion to their ownership shares. Each of the owners has agreed to indemnify the others in such cases.

Nuclear Liability and Insurance

Pursuant to the Price-Anderson Act, which was reauthorized through December 31, 2025, by the Energy Policy Act of 2005, KEPCo is required to insure against public liability claims resulting from nuclear incidents

to the full limit of public liability, which is currently approximately $10.8 billion. This limit of liability consists of the maximum available commercial insurance of $300.0 million, and the remaining $10.5 billion is provided through mandatory participation in an industrywide retrospective assessment program. Under this retrospective assessment program, owners are jointly and severally subject to an assessment of up to $100.6 million ($6.0 million–KEPCo's share) at any commercial reactor in the country, payable at no more than $15.0 million ($0.9 million–KEPCo's share) per incident per year, per reactor. This assessment is subject to an inflation adjustment based on the Consumer Price Index and applicable premium taxes. This assessment also applies in excess of the worker radiation claims insurance. The next scheduled inflation adjustment is scheduled for July 1, 2008. In addition, Congress could impose additional revenue-raising measures to pay claims.

The owners of Wolf Creek carry decontamination liability, premature decommissioning liability and property damage insurance for Wolf Creek totaling approximately $2.8 billion ($168.0 million–KEPCo's share). This insurance is provided by Nuclear Electric Insurance Limited (NEIL). In the event of an accident, insurance proceeds must first be used for reactor stabilization and site decontamination in accordance with a plan mandated by the Nuclear Regulatory Commission. KEPCo's share of any remaining proceeds can be used to pay for property damage, decontamination expenses, or if certain requirements are met, including nuclear decommissioning the plant, toward a shortfall in the decommissioning trust fund.

The owners also carry additional insurance with NEIL to cover costs of replacement power and other extra expenses incurred during a prolonged outage resulting from accidental property damage at Wolf Creek. If significant losses were incurred at any of the nuclear plants insured under the NEIL policies, KEPCo may be subject to retrospective assessments under the current policies of approximately $1.6 million.

Although KEPCo maintains various insurance policies to provide coverage for potential losses and liabilities resulting from an accident or an extended outage, KEPCo's insurance may not be adequate to cover the costs that could result from a catastrophic accident of extended outage at Wolf Creek. Any substantial losses not covered by insurance, to the extent not recoverable through rates, would have a material adverse effect on KEPCo's financial condition and result of operations.

Decommissioning Insurances

KEPCo carries premature decommissioning insurance that has several restrictions, one of which can only be used if Wolf Creek incurs an accident exceeding $500.0 million in expenses to safely stabilize the reactor, to decontaminate the reactor and reactor station site in accordance with a plan approved by the Nuclear Regulatory Commission (NRC) and to pay for on-site property damages. Once the NRC property rule requiring insurance proceeds to be used first for stabilization and decontamination has been complied with, the premature decommissioning coverage could pay for the decommissioning fund shortfall in the event an accident at Wolf Creek exceeds $500.0 million in covered damages and causes Wolf Creek to be prematurely decommissioned.

Nuclear Fuel Commitments

At December 31, 2006, KEPCo's share of WCNOC's nuclear fuel commitments was approximately $9.6 million for uranium concentrates expiring in 2017, $1.3 million for conversion expiring in 2017, $18.6 million for enrichment expiring at various times through 2024, and $6.8 million for fabrication through 2024.

Purchase Power Commitments

KEPCo has supply contracts with various utility companies to purchase power to supplement generation in the given service areas. KEPCo has a five-year contract with Westar Energy, Inc. through May 2008, with minimum purchase commitments of 85 megawatts per year.

KEPCo has provided the Southwest Power Pool a letter of credit to help insure power is available if needed.

Note 12: Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value as set forth in SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*.

Cash and Cash Equivalents – The carry amount approximates the fair value because of the short-term maturity of these investments.

Decommissioning Trust, Investments in Associated Organizations and Bond Fund Reserve – The fair value of these assets is primarily based on quoted market prices as of December 31, 2006.

Variable-Rate Debt – The carrying amount approximates the fair value because of the short-term variable rates of those debt instruments.

Fixed-Rate Debt – The fair value of the fixed-rated FFB debt and the fixed-rate Series 1997 Trust debt is based on the sum of the estimated value of each issue, taking into consideration the current rates offered to KEPCo for debt of similar remaining maturities.

The estimated fair values of KEPCo's financial instruments are as follows:

	December 31, 2006	
	Carrying Value	**Fair Value**
Cash and cash equivalents	$ 3,271,471	$ 3,271,471
Investments in associated organizations (including investments in CFC)	3,372,153	3,372,153
Bond fund reserve	4,295,806	4,479,135
Decommissioning fund	9,245,665	9,245,665
Fixed-rate debt	126,734,987	126,178,186
Variable-rate debt	26,700,000	26,700,000

Note 13: Patronage Capital

In accordance with KEPCo's by-laws, KEPCo's current margins are to be allocated to members. KEPCo's current policy is to allocate to the members based on revenues collected from the members as a percentage of total revenues. If KEPCo's consolidated financial statements were adjusted to reflect accounting principles generally accepted in the United Stated of America, total patronage capital would be negative. As noted in the consolidated statements of changes in patronage capital, no patronage capital distributions were made to members in 2006 and 2005.

Note 14: Future Change in Accounting Principle

The FASB recently issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans* (SFAS 158), which revises the accounting and disclosure requirements in the financial statements of employers with respect to defined benefit pension and other postretirement plans. The statement requires an employer to currently recognize the funded status of defined benefit plans, the difference between the fair value of plan assets and the projected benefit obligation on the employers' balance sheet. SFAS 158 is effective for fiscal years ended after June 15, 2007; thus, the Cooperative expects to first apply the recognition of the funded status during its year ending December 31, 2007. Additionally, the statement has eliminated the current measurement option and requires the measurement date to be as of the balance sheet date for fiscal year ending after December 15, 2008. The Cooperative's measurement date is currently as of the balance sheet date.

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Sections 14 and 15

Additional evidence.

Sections 14 and 15. *Additional evidence.* These sections include all other schedules, exhibits and data deemed pertinent to the application which may not be properly included under the preceding sections. This additional evidence may be submitted at the option of the applicant and shall be submitted upon the direction of the commission.

14 & 15

Kansas Electric Power Cooperative, Inc.

2007 Financial Plan and Analysis of Margin Requirements

Presented by:

GDS Associates, Inc.
J. Bertram Solomon

August 15, 2007

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I. PURPOSE

GDS Associates, Inc. was retained by Kansas Electric Power Cooperative, Inc. ("KEPCo") to conduct a financial assessment in light of KEPCo's deteriorating financial condition and to provide recommendations to reverse this trend and to support KEPCo in its upcoming rate filing. This assignment also included the development of a recommended times interest earned ratio ("TIER") or debt service coverage ("DSC") target, as appropriate, for purposes of establishing KEPCo's margin requirements for its upcoming rate filing with the State Corporation Commission of Kansas ("KCC" or "Commission"). In conducting our analyses, it was clear that we needed to factor long-term considerations into our evaluations. While the upcoming rate filing and the need to rebuild KEPCo's seriously depleted cash balances present obvious immediate needs, other challenges lie ahead that will require tangible demonstration of KEPCo's commitment to developing and maintaining long-term financial soundness. As new and replacement power supply resources are required in the future, KEPCO will increasingly be required to demonstrate its credit worthiness to wholesale power suppliers (when it chooses purchased power options) and to lenders (if it chooses generation ownership options). In our view, KEPCo should reaffirm its commitment to building and maintaining its financial strength in order to assure its long-term viability and future financial and power supply flexibility. This report presents the results of our analyses and our conclusions and recommendations.

II. BACKGROUND AND OVERVIEW

Our analyses and evaluations have been specifically guided by the parameters of KEPCo's current financial policy as adopted by KEPCo's Board of Trustees, as well as its approval and adoption of our May 2001 recommendations and the October 2005 update. This statement of financial policy is contained in Policy Bulletin No. 9, dated April 16, 1998, which is included in this report as Attachment No. 1. The elements of KEPCo's financial policy may be summarized as follows:

A. Adjust KEPCo's wholesale power rates as necessary to maintain KEPCo in a sound financial position.

B. Maintain KEPCo's wholesale power rates at a level that will produce a margin from KEPCo's operations.

C. Maintain wholesale power rates that will produce revenues, which shall be sufficient, with the revenues of KEPCo from all other sources, (1) to meet the costs of operation and maintenance, (2) to maintain a reasonable level of working capital, and (3) to meet all applicable mortgage requirements.

D. Pay capital credits which have accrued on KEPCo's records to its Members on a seven-year rotation schedule.

E. Recognize that all wholesale power rates and the rate schedules as approved by the Board of Trustees are subject to the jurisdictional authority of appropriate regulatory agencies and KEPCo's bankers.

In our 2001 report, we recommended the use of a 1.2 times interest earned ratio ("TIER") as a short-term financial target and for use in establishing the margin

component of KEPCo's revenue requirement for ratemaking purposes. We also recommended that intermediate and longer term goals be adopted including year-end cash balances of $15 million, a $15 million line of credit, and equity or patronage capital of at least 20% of total assets. Furthermore, we suggested reviewing the continued reasonableness of these targets and KEPCo's progress in attaining them every three to five years. Those recommendations were adopted by the Board of Trustees in May 2001. These recommendations were updated in October 2005 to a year-end cash balance of $14 million and a $14 million line of credit.

As a result of changes in KEPCo's power supply contracts and other factors, KEPCo's financial condition has recently deteriorated significantly and is expected to continue to deteriorate under KEPCo's present rates. Therefore, KEPCo must increase its wholesale rates and modify its rate design in order to meet the requirements of its financial policy and attain a financially sound footing on which to engage the increasingly challenging and competitive electric utility environment. We note that events subsequent to KEPCo's last rate change have caused the focus on cash requirements to become even more important to its rate case planning. KEPCo now requires substantially more cash to meet the growing principal payment requirements on its current and upcoming loans than is generated through the depreciation and amortization components built into its currents rates and than will be built into its new rates. This means that the additional cash required to make the full amount of these principal payments must come from increased margins built into the rates. Thus, debt service coverage ("DSC") and cash requirements have now become the primary factors that determine the margin component of

KEPCo's future revenue requirements and rates, rather than its accrual accounting (or income statement) based TIER target. Therefore, we are recommending the use of a 1.2 DSC, with an appropriate demand-related purchased power cost adjustment ("PPCA") mechanism, rather than a 1.2 TIER, for determining KEPCo's margin requirement in its upcoming rate filing.

Our near and longer term recommended financial targets are year-end cash balances of $14 million, a line of credit of $14 million, a DSC of 1.2, TIER of 1.2, and a long-term goal for equity or patronage capital of 20% of total assets (as measured on the basis of generally accepted accounting principles ("GAAP")).

We believe the recommended addition of a demand-related PPCA is important to building and maintaining KEPCo's financial integrity due to the significant lag that KEPCo experiences in the process of considering, developing, filing, and implementing rate changes. In addition, the demand-related costs for purchases under the new Westar purchased power contract will be based on formulary rates that will change annually to track changes in Westar's fixed costs. However, at the request of KEPCo's Board, we have considered what DSC target we would recommend if the Board decided not to include a demand-related PPCA provision in KEPCo's rates. In that event, we would recommend a 1.3 DSC target. While the demand-related PPCA is no panacea, we believe it would help to mitigate KEPCo's financial risk and without it, we believe it would be wise to accelerate the rebuilding of KEPCo's badly depleted cash balances. We would also point out that a 1.30 DSC target is still less than the 1.36 DSC that KCC Staff witness Rohrer testified would be produced as a result of using his recommended 1.30 TIER for the test year in KEPCo's 2001 rate proceeding. We recommend reviewing the

continued reasonableness of these targets and KEPCo's progress in attaining them every one to two years. If the 1.3 DSC target is used for the upcoming rate change without the addition of a demand-related PPCA provision, it would be appropriate to re-evaluate the continued need for the 1.3 DSC after the $14 million cash balance target is achieved and maintained for a reasonable time period.

III. STUDY METHODOLOGY

Our review and evaluations were conducted by a team of experienced consultants led by J. Bertram Solomon. Mr. Solomon had overall responsibility for the project and this report. He was assisted by Dr. William R. Jacobs, who was responsible for an analysis of the nuclear risks faced by KEPCo; and Brian D. Smith, who was responsible for cash flow forecasts for the next several years and forecasts of annual revenues, expenses and resulting financial statements through the year 2022. Mr. Smith's past experience assisting KEPCo in evaluating alternative power supply resources was very helpful in conducting our analyses on this project. Assistance and advice was also provided by Stephen Page Daniel, who has long provided KEPCo assistance in power supply and transmission service contract matters. Of course, our assignment could not have been completed without the invaluable assistance of KEPCo's management and staff.

In the execution of this project, we interviewed KEPCo management personnel, requested a significant amount of historical and forecasted financial and accounting information, conducted financial ratio and other analyses, and made cash flow forecasts for the next several years and forecasts of annual income statements, cash flow and balance sheets through the year 2022. We reviewed and assessed KEPCo's historical cash flow requirements, analyzed changes currently

occurring with KEPCo and its' Members, as well as anticipated changes within the region and nationally, that may have an affect on cash working capital, cash maintenance and short-term capital requirements. Such factors included, but were not limited to, the extent to which the receipt of revenue for monthly service matches the requirement for cash expenditures incurred in providing such monthly service; the uneven nature of KEPCo's cash requirements for large expenditures such as purchased power costs, principal and interest payments, Wolf Creek O&M costs, and property tax expenditures; the impact of KEPCo's previous practice of basing Member rates, in part, on Wolf Creek debt service (sinking fund) requirements rather than straight-line depreciation and interest requirements, subsequent switch to straight-line depreciation in 2002, and increasing mismatch between loan principal payments and booked depreciation and amortization expense; rate design considerations such as the need for a demand-related purchased power cost adjustment provision in KEPCo's Member rates and how fixed costs are recovered through demand charges and variable costs are recovered through kWh energy charges; recent and imminent changes to the pricing structures in KEPCo's Sunflower and Westar power supply contracts; expected changes in KEPCo's power supply mix and cost structure; anticipated market changes due to industry restructuring and the potential loss of Member retail load; the collection of margins through rates; the effects of non-Member income; the impact of funding requirements for nuclear decommissioning, spent fuel disposal and other reserves; as well as potential operating contingencies such as loss of Wolf Creek generation for short or extended periods and the need to acquire replacement power.

In conducting our evaluations and drawing our conclusions, we have drawn not only upon our broad industry experience developed through working for approximately 20 G&T cooperatives throughout the nation and the detailed analysis of the financial condition and cost structure of over 30 major investor-owned electric utilities, we have also drawn upon the independent, objective credit quality guidelines provided by two of the premier credit analysis institutions in the U.S., Moody's Investors Service ("Moody's") and Standard & Poor's Ratings Services ("S&P" or "Standard & Poor's"), the requirements of KEPCo's major bankers, the Rural Utilities Service ("RUS") and National Rural Utilities Cooperative Finance Corporation ("CFC"), as well as comparisons with KEPCo's electric cooperative peers.

IV. RECENT FINANCIAL RESULTS

KEPCo's current member rates were placed into effect in accordance with the order of the KCC in February 2002. In its order, the KCC, among other things, approved KEPCo's use of a 1.2 TIER in determining its margin requirement and recognized the reasonableness of its 20% minimum equity ratio target. Also, the Commission approved KEPCo's proposed energy cost adjustment ("ECA") provision. In addition to these findings that have had beneficial effects on KEPCo's financial recovery, the KCC also imposed requirements that have already begun to mitigate those beneficial effects and that could harm KEPCo's ability to meet its cash requirements and mortgage coverage requirements in the future without proper recognition in future rate proceedings. Those requirements were that KEPCo significantly reduce its booked depreciation expenses by switching from use of the sinking fund depreciation rates for Wolf Creek that closely matched the Wolf Creek

loan principal payments to straight-line depreciation rates and to further reduce those depreciation rates by extending its expected useful life by an additional 20 years from 40 to 60 years.

Similar to a home mortgage, the principal payments on the loans used to finance the Wolf Creek investment are lower in the early years and higher in the latter years of their repayment. One of the beneficial effects of the use of sinking fund depreciation rates had been that it reasonably closely matched the cash collected through the portion of KEPCo's rates set to recover its depreciation expense with the cash required to make the principal payments on its loans. The use of sinking fund depreciation for book and ratemaking purposes also helped keep KEPCo's Member rates lower than they otherwise would have been during the early years of Wolf Creek's life. The KCC's requirement that KEPCo switch to straight-line depreciation rates for Wolf Creek at a time when the related principal payments and sinking fund depreciation rates have become greater than the straight-line depreciation rates and are increasing, means that the cash collected through the portion of KEPCo's rates set to recover depreciation expense now falls below the cash required to make loan principal payments and that gap is widening. This detrimental shortfall in cash collected compared to the cash payment requirements is exacerbated by the further requirement to use a 20-year longer depreciable life that reduces the annual depreciation expense and stretches the recovery of the Wolf Creek investment far beyond the date on which the related loans must be repaid. While the Commission did allow the recovery of the accumulated difference between the prior sinking fund depreciation expenses and straight-line depreciation expenses over 15 years, that still will not be enough to

prevent a significant and growing gap between the resulting book depreciation and amortization expenses and the required loan principal payments. Fortunately, the Commission did recognize this problem and concluded that KEPCo would need larger margins driven by DSC requirements until its Wolf Creek related debt is paid off.

In addition to causing a cash shortage problem absent proper future ratemaking recognition and adjustment of rates, the mismatch between revenue collected based on straight-line depreciation expense and paid out as loan principal payments also has the potential to cause KEPCo to fail to meet the 1.0 DSC (average for the highest two out of every three years) requirement in its RUS/CFC mortgage. As long as the book depreciation expense collected through rates is about the same as the loan principal payments, the TIER and DSC ratios are about the same. However, since the booked depreciation expenses and related loan principal payments are incorporated into the DSC, but not the TIER calculation, when the book depreciation expense varies significantly from the loan principal payments, the TIER and DSC ratios diverge significantly. When loan principal payments are significantly more than recorded depreciation expense, financial results that produce a healthy TIER ratio well above 1.0 could produce an anemic DSC ratio well below 1.0. When the differences become large enough, as KEPCo is currently experiencing and is expected to continue to experience for many years, the DSC and related cash requirements must become the driver for the determination of the margin requirement used for ratemaking purposes. While this may cause accrual-based margins reported on the income statement and the

resulting TIER ratios to become large by historical standards, it will be required to meet cash and mortgage requirements.

Table 1: KEPCo TIER, DSC, Cash Balances and Equity Ratio

	TIER	DSC	Year-End Cash And Equivalents	Equity as a % of Assets Non-GAAP	Equity as a % of Assets GAAP
1998	1.34	1.15	$5,548,140	5.0%	-19.6%
1999	1.09	1.03	$4,893,273	5.5%	-21.5%
2000	0.95	1.07	$3,203,938	4.9%	-23.6%
2001	0.65	0.93	$5,655,642	4.2%	-29.5%
2002	1.25	1.23	$8,036,064	4.6%	-24.6%
2003	1.20	1.11	$8,226,833	5.4%	-19.9%
2004	1.34	1.09	$9,410,810*	7.1%	-16.6%
2005	1.39	1.08	$8,871,500*	9.0%	-12.4%
2006	1.12	0.94	$3,271,471	9.5%	-9.5%
2007 (Est.)	1.23	0.95	$3,743,600**	9.5%	-5.5%

*Includes KEPCo's RUS cushion of credit balance.
**Includes $4.8 million Wolf Creek capital additions loan.

As Table 1 above shows, KEPCo's TIER and DSC ratios hit bottom at 0.65 and 0.93, respectively, in 2001. After the new rates were placed in effect in February 2002, KEPCo's TIER has been at or above 1.20 each year, at least until 2006, when it dipped to 1.12. However, while the DSC ratio improved to 1.23 in 2002, evidencing the depreciation expense versus loan principal payment issue described above, the DSC subsequently has steadily declined to 1.08 in 2005 and dropped below 1.0 to 0.94 in 2006, and is projected to remain less than 1.0 at 0.95 in 2007. Year-end cash and cash equivalents balances declined during the latter part of the 1990's hitting an initial bottom at $3.2 million in 2000 and subsequently improved each year up to $9.4 million in 2004 before falling again to $8.9 million in 2005 and $3.3 million by the end of 2006. Thus, at the beginning of this year, KEPCo's cash balance had again dropped to an extremely low level and was in need of

rehabilitation to a safer and more reasonable level. Subsequently, however, KEPCo's month-end cash balance dropped even lower to just $1.1 million at the end of June 2007. With its lumpy principal payment requirements, lag in collection of revenues to cover purchased power payments, and the coming increase in Westar demand charge payments we discuss below, among other things, before the year is out, KEPCo's cash balance could easily drop further to below the $1.1 million level and could even be eliminated entirely. Although KEPCo forecasts a 12/31/07 cash balance of $3.7 million, that projection assumes receipt of a $4.8 million RUS loan that has yet to materialize, and even after its receipt would still leave KEPCo's year-end cash balance at near its lowest levels over the past decade. Clearly, KEPCo's rates are in need of immediate attention.

Meanwhile, KEPCo's equity to assets ratio has shown steady improvement since 2001. From its low point of 3.1% in 2001, it has improved to 9.5% in 2006 on a non- Generally Accepted Accounting Principles ("GAAP") basis. However, when measured in accordance with GAAP, even though it had improved from -29.5% in 2001 to -9.5% in 2006, KEPCo's equity to assets ratio was still well below zero at the end of 2006 and is expected to remain below zero until sometime in 2009. Thus, on a standard accounting and reporting basis, KEPCo still has a long way to go in building toward its 20% equity ratio target.

V. FINANCIAL FORECAST AND SHIFTING CONDITIONS

KEPCo's current base case financial forecast bears the evidence of the growing difference between its required loan principal payments and its booked depreciation expenses. As shown in Table 2, below, KEPCo anticipates loan principal payments in excess of recorded depreciation expenses of $3.5 million in

2007 and that difference is expected to increase steadily each year to $5 million by 2009 and up to $10.6 million by 2015, when the majority of the Wolf Creek related debt will be paid off.

Table 2: Forecast Amount by Which KEPCo's Required Loan Principal Payments Exceed Its Recorded Depreciation and Amortization

2007	$3,497,300
2008	$4,271,000
2009	$5,011,200
2010	$5,152,700
2011	$5,598,100
2012	$6,710,500
2013	$7,708,400
2014	$8,926,400
2015	$10,578,200

Consistent with that expectation of growing differences in loan principal payments and booked depreciation expenses, KEPCo has been expecting its accrual accounting (income statement) based TIER and equity to assets ratios to be slowly increasing over the years, but that its more cash driven DSC ratio and its related cash balances would be doing the opposite – slowly declining. It further expected the decline in the DSC and cash balances ultimately to drive the need for a rate increase in the 2008 to 2009 time frame.

That expected scenario was playing out reasonably well in reality until the negative short term effects of the new Sunflower purchased power contract were experienced in the latter half of 2006 and into 2007. While that contract change will have the overall beneficial effect of steadying KEPCo's costs over the long term, its restructured demand and energy charges have had adverse effects on cash flow in the short term, since KEPCo's demand rates to its members are fixed and its ECA flows through changes in variable energy costs. On the heals of that cash drain

and during KEPCo's ongoing deliberations and preparations for making its next rate filing with the KCC, large mid-year payment requirements and abnormally mild weather with attendant lower than expected revenues have acted to further deplete its cash balance. These experiences are vivid examples of the various kinds of things we pointed out in our 2001 report that KEPCo could face and demonstrate the need to build and maintain reasonable, but significant cash balances and credit lines in order to provide short term financial resilience and meet its many ongoing responsibilities to its members and other stakeholders. With cash balances now nearly depleted, prudent action is needed to rebuild them and to further fortify against a recurrence, to the extent reasonably possible, especially as KEPCo now turns to face another similar challenge to its cash flow.

That challenge is expected to be faced beginning in November 2007 with the start of a new power purchase agreement with Westar and is expected to significantly reduce KEPCo's margins and related financial ratios for 2008 and beyond, absent a change in KEPCo's member rates. Even though the overall average costs under the new Westar contract are expected to be less than under the current contract resulting in net cost savings, the pricing structure will be changing very significantly and in a way that will be detrimental to near term cash flow. The demand charges under the new Westar contract will be increasing greatly and the energy charges will be significantly reduced. Without a change in the design of KEPCo's member rates, its ECA provision will reduce member rate revenues once the contract is placed into effect as a result of the flow through of the reduction in purchased energy costs, but KEPCo's demand charges will not increase to reflect the increase in demand-related purchased power costs. Thus,

KEPCo's margins reasonably may be expected to disappear in 2008 and even become significantly negative with resulting TIER and DSC ratios substantially below 1.0, a reduction in its equity ratio, and complete depletion of its cash balance and attendant requirement for borrowing to meet operating costs unless its rate design is changed.

Recognizing this fact, KEPCo is preparing to make a rate change request before the KCC to address this matter and to better align its rates with its costs. However, in light of the Commission's procedural requirements, it is unlikely that rate relief will be experienced before the middle of 2008. Meanwhile, KEPCo's financial condition already will have been adversely impacted for several months in 2007 and 2008 due to the rate change lag inherent in the regulatory process. It is our understanding that KEPCo has begun discussions with the KCC on an interim rate design accommodation to allow it to offset some of the increased demand charges under the new Westar contract by not passing some of the energy savings to Members until a new rate is approved by the KCC in 2008. If KEPCo is successful in reaching this interim rate accommodation, it would help KEPCo stave off further deterioration of its financial position.

It is also our understanding that KEPCo is evaluating a demand-related purchased power cost adjustment provision as part of its rate filing. We recommend the adoption of such a provision in order to help avoid the adverse cash flow consequences of any future changes in purchased power contracts like those KEPCo is currently experiencing.

It is currently expected that the mid-2008 rate change, if based on a test year DSC target of 1.2, should avert the incurrence of a negative margin for 2008,

allow KEPCo to continue to meet its mortgage TIER and DSC requirements, and foster the continued advancement toward KEPCo's goal of attaining a minimum GAAP equity to assets ratio of 20%. Of course, it remains to be seen whether these expectations will survive the rate change process required for KEPCo and whether the planned rate change can be placed into effect in time to avert significant short term borrowings to meet operating requirements. Additionally, if the process of preparing and making the filing is delayed such that the effective date of a contested rate is pushed much beyond July 1, 2008, KEPCo could be in jeopardy of failing to meet its mortgage coverage requirements. If this were to happen, it would be seriously detrimental in that KEPCo will be relying on RUS long-term borrowings to maintain some of its cash position and it would be very difficult to obtain additional loans from RUS if mortgage requirements are not met.

Also, while the anticipated rate change should be helpful in avoiding further deterioration in KEPCo's financial condition, it will still not slow the widening gap discussed above between the depreciation expenses built into rates and the loan principal payments required to service KEPCo's debt. Thus, it is still anticipated that future rate changes will continue to be necessary and that they will be driven by KEPCo's DSC and cash requirements rather than its strictly accrual accounting (income statement) based TIER requirements.

VI. INCREASING BUSINESS NEEDS FOR STRONGER CREDIT METRICS

Over the last several years, creditors and counter-parties in the electric utility industry have placed more emphasis on assessing and requiring assurances of the credit worthiness of entities with which they do business. The Enron debacle

called attention to this need and that attention has continued to grow since that time. Examples of the way these growing requirements affect KEPCo are the credit conditions imposed in the Southwest Power Pool transmission tariff to access transmission service and the credit requirements being imposed by Westar in its new purchased power agreement. In addition, in order to maintain a reasonable balance between owned generation resources and power purchases, KEPCo is facing large capital additions requirements in the future. While it is currently expected that these additions will be subject to favorable financing terms from the RUS and CFC, the future of such continued financing is not certain. RUS has recently announced that it has placed a hold on any future funds for base load generation facilities. When and if that hold may be lifted or if it might be expanded to other types of generating facilities in the future is also unknown.

Therefore, it is wise for KEPCo to continue to steadfastly pursue the improvement of its financial condition it began in 2001 and 2002 to the point where it could achieve a solidly investment grade credit rating from the major credit rating agencies like Moody's Investor Services ("Moody's") or Standard & Poor's ("S&P"). The development and consistent application of a prudent financial plan is a necessary step in that direction. The institution of an automatic cost adjustment provision that would provide reasonably current and assured recovery of not only energy-related fuel and purchased power costs, but also demand-related purchased power costs would be another step in that direction. In our 2001 Financial Plan and Analysis of Margin Requirements report, we related some of the more important factors that Moody's examines in determining the financial soundness and credit worthiness of G&T electric cooperatives as discussed in its December 2000 special

report entitled "A Credit Perspective on U.S. Electric Cooperatives," and we included the full Moody's report as an attachment to our report. While we are not attaching that report here, we will reiterate and build on some of our previous discussion of the Moody's report in the section on Application of KEPCo's Financial Policy Statement. Moody's has not updated that report, but to the best of our knowledge, among the myriad of factors Moody's considers in developing its credit ratings for G&T electric cooperatives, it still places significant emphasis on the three major factors we highlighted in our report and factored into our recommendations at that time: (1) TIER; (2) equity as a percent of assets; and (3) the maintenance of "large" cash balances.

More recently though, another of the big three credit rating agencies, S&P, published a three-part series of articles all dated November 2, 2006 on S&P's credit rating methodology for U.S. power cooperatives: "An Overview," "Key Business Risks," and "Key Financial Indicators." These articles are attached to this report. Like Moody's, S&P emphasizes that its ratings are not based on a formula approach – "the ratings process is as much an art as science." Nonetheless, S&P does describe some of the factors that heavily influence its cooperative ratings. S&P begins with an assessment of a cooperative's business and competitive risk profile. Based on that assessment, it assigns a business risk profile score from 1 to 10 where 1 represents the lowest risk and 10 the highest risk. After the business risk profile is determined, S&P uses financial analysis to determine a cooperative's financial risk profile.

The most important factor in S&P's determination of a cooperative's business risk profile score is the regulation of its rates, either through its own self-regulation

or a state or federal regulatory body. S&P notes that most cooperatives are self-regulated (seeing RUS rate regulation as effectively "benign") and notes that one of the key credit features of cooperatives is their ability to set their own electric rates; however, how well they function in that role to maintain financial strength is carefully evaluated. If a cooperative does face state regulation like KEPCo does, S&P says that "all else being equal, its business profile can be expected to receive a weak regulatory score." In practical terms, this means that in such instances, the maintenance of good financial indicators is all the more important to getting a good credit rating.

A few questions S&P lists as important in the rate setting area and that are applicable to KEPCo especially in its present circumstances are: (1) What is the process for raising rates and how much time does this take? (2) Does the cooperative have a fuel and purchased power adjustor and how strong is it? (3) Has the cooperative in the past allowed financial performance to lag rather than raise rates charged to members or customers? Given the extensive time requirements involved in going through its Board approval, rate filing preparation, and state commission regulatory process, KEPCo has been unable to react quickly to changing cost structures such as the Sunflower and Westar purchased power contract changes. Therefore, the answer to each of these questions has become problematic for KEPCo. The addition of a demand-related purchased power adjustment provision in the upcoming rate filing, while not eliminating concerns raised by these questions, would help significantly and we recommend that it be pursued before the Commission.

In discussing key financial indicators for cooperatives, S&P emphasizes cash flow metrics. For example: it notes that "since there is often a wide discrepancy between earnings and actual cash flow, achievement of accrual-based targets does not necessarily assure that operating cash flows will be sufficient to cover financing charges." We recognize this concern by continuing to recommend that current and future rates, at least for several years to come, be set based on the DSC target of 1.2 rather than an accrual accounting (income statement) based TIER measure. S&P also says that cash flow adequacy "is an important consideration in assessing financial strength for all cooperatives and perhaps the most important aspect of the financial profile for cooperatives that cannot set their own rates." The addition of a demand-related purchased power adjustment provision to its rates and the more consistent achievement of a 1.2 DSC would provide enhanced cash flow adequacy and enable KEPCo to attain greater financial stability and credit worthiness.

While S&P, like Moody's, does not provide minimum or even guideline financial benchmarks required for particular rating levels, it did emphasize three other important areas of review in its discussion of key financial indicators in addition to cash flow adequacy: (1) capital structure, (2) financial flexibility and liquidity, and (3) financial policy. Between our financial plan reports and KEPCo's financial policy, each of these key areas are addressed.

In addressing the capital structure topic, S&P noted that the equity ratios of rated G&T's average about 19%, which is nearly the same as the target set by KEPCo. It should be noted, however, that this 19% is based on GAAP accounting and while we believe KEPCo is on the path to getting into positive territory on a

GAAP basis within the next couple of years, it will still be building up toward the 19% - 20% GAAP-based level for several years thereafter.

S&P then says, that financial flexibility and liquidity "together capture a utility's ability to respond to adverse events so as to protect its capacity to meet financial obligations in a timely manner." S&P here highlights cash on hand including undrawn bank line capacity and states that "access to short term credit is especially important for all electric cooperatives, including the majority that continues to rely on RUS for long-term financing." This consideration is discussed at length in this report and is addressed by our recommendations of adoption of a demand-related purchased power adjustment provision and achievement and maintenance of $14 million as a representative cash balance along with maintenance of a readily available line of credit of $14 million.

Finally, in discussing financial policy, S&P states that "financial targets can address earnings or cash flow coverage, debt leverage and member dividends." Through its TIER, DSC, equity as a percent of assets (which is essentially the opposite side of the debt leverage coin), and capital credit rotation policies, KEPCo addresses each of these major financial policy concerns of S&P.

VII. APPLICATION OF KEPCO'S FINANCIAL POLICY STATEMENT

KEPCo's existing financial policy statement is based upon solid, common sense financial principles. The application of these principles, as constrained by regulatory rulings, should result in a strong, vibrant and financially sound, yet competitive, power supplier for KEPCo's Member owners. We address the current application of each of these principles below.

A. Maintain a Sound Financial Position.

It is important for KEPCo to maintain a sound financial position for several reasons. First, it provides KEPCo the ability to carry out its mission. Second, the maintenance of a sound financial position demonstrates corporate integrity and financial and social responsibility. Third, it provides important operational and financial flexibility needed to successfully navigate the increasingly changing political, social and economic environment. Finally, the current business environment demands that KEPCo maintain a sound financial position in order to continue to function as a wholesale power supplier. As a result of national and state political policy, the electric utility industry is becoming increasingly more competitive at all levels. Successfully operating in a more competitive environment requires a sound financial footing. KEPCo has committed to the support of construction and joint ownership of a new coal-fired base load generating facility that is currently expected to become commercially operable in 2010 and has negotiated a new long-term partial requirements purchase power contract with Westar Energy. In order to preserve its future power supply flexibility and ability to reasonably diversify its resources in the future, KEPCo will need to be able to demonstrate its credit worthiness. Wholesale power suppliers in the current markets are requiring the demonstration of financial soundness in order to commit to supplying such power requirements, as evidenced by KEPCo's new contracts with Westar and Kansas City Power and Light. Also, in order to participate in new generation projects such as Iatan 2 with partners and to obtain financing for generation ownership, even from traditional sources of cooperative financing, KEPCo would be required to demonstrate its credit worthiness. Gone are the days

of being able to rely on the U.S. government for 100% financing for generation resources or 100% loan guarantees.

In order for KEPCo to demonstrate that it is financially sound, it must be able to show that it can meet its ongoing obligations, it has the ability to withstand financial and operating challenges, it consistently earns a reasonable level of margins, and it has developed or has a viable plan for developing a strong balance sheet. Credit rating agencies regularly provide independent reviews of the financial soundness and degree of credit worthiness of electric utilities – both cooperatives and investor-owned utilities. Therefore, it is instructive to understand some of the key considerations made by these independent arbiters of electric utility credit worthiness in determining the financial soundness of an electric utility. Moody's is one of the oldest and most widely respected independent credit rating agencies serving the electric utility industry. In a December 2000 special report entitled "A Credit Perspective on U.S. Electric Cooperatives," Moody's discusses several key indicators it uses to determine the financial soundness of G&T electric cooperatives. We used that special report in preparing our 2001 KEPCo Financial Plan report, and it is our understanding that it has not been updated by Moody's since that time. While Moody's considers a myriad of factors in developing its credit ratings, it places significant emphasis on the following three factors in assessing the degree of credit worthiness of G&T electric cooperatives and these factors line up closely with those articulated by S&P in its more recent report on its cooperative credit rating methodology, as discussed above:

(1) TIER;

(2) Equity as a percent of assets; and

(3) The maintenance of "large" cash balances.

Tables 3 and 4 below show how KEPCo compares with its electric cooperative industry peers for its TIER and how KEPCo's cash balances have deteriorated in recent years. Table 5 compares KEPCo's equity as a percent of assets with that of the peer groups. All of these indicators demonstrate that KEPCo needs to re-emphasize the importance of its policy of maintaining its financial soundness and adopt and implement a plan to restore and strengthen its financial condition.

Table 3: TIER Ratios

	1998	1999	2004	2005
KEPCo's Mortgage Requirement	1.05	1.05	1.05	1.05
Moody's G&Ts (11)	1.41	1.35	N/A	N/A
RUS G&Ts (over 30)	1.78	1.68	1.81	1.67
KEPCo Members	3.79	2.88	3.21	2.65
KEPCo	1.34	1.08	1.34	1.39

KEPCo 2000:	0.95
KEPCo 2001:	0.65
KEPCo 2002:	1.25
KEPCo 2003	1.20
KEPCo 2004	1.34
KEPCo 2005	1.39
KEPCo 2006	1.12
KEPCo 2007 (forecast)	1.23

Table 3 shows that, KEPCo's TIER ratios generally have been below those of its G&T cooperative peer groups, and they have not been consistent over time. As would be expected, KEPCo's Members have experienced much higher TIER ratios than KEPCo. While comparable DSC ratios are not readily available for the G&T comparison groups, as discussed at length in other parts of this report, it is clear that KEPCo's ratemaking margin requirement must now be based on a DSC rather than TIER target. Nonetheless, Table 3 is useful to show how KEPCo's past

experience has compared with its peers in terms of this other key financial indicator.

Table 4, below, shows that KEPCo's cash balances have also risen and fallen significantly over time. KEPCo had an average cash balance of just over $16.6 million for the period 1996-1999. It then dropped to $3.2 million by the end of 2000, climbed back to $9.4 million at the end of 2004, and then fell to $3.3 million by the end of last year. As discussed above, KEPCo's cash balances had dropped to just $1.1 million by the end of June 2007. While many factors affect KEPCo's financial results, as recognized by both Moody's and S&P, they are most heavily influenced by its rate setting and regulatory process. KEPCo implemented a rate reduction of almost 10% at the end of 1998. That reduction and the lack of an automatic fuel and purchased power adjustment provision in KEPCo's rates in the face of the drastic increases in fuel prices in 1999 and 2000 that were passed on to KEPCo through the automatic fuel adjustment provisions that were included in the wholesale rates of its power suppliers caused significant deterioration in its financial condition. After instituting a rate increase in early 2002 that included an energy cost adjustment provision, KEPCo's financial condition received a needed boost, but then began to deteriorate again with time and cost increases that were not covered by its energy cost adjustment provision.

Table 4: KEPCo Cash Balances

Date	Cash Balance
12/31/96	$18,810,807
12/31/97	$15,924,053
12/31/98	$18,284,200
12/31/99	$13,694,842
12/31/00	$ 3,203,938
12/31/01	$ 5,655,642
12/31/02	$ 8,036,064
12/31/03	$ 8,226,833
12/31/04	$ 9,410,810*
12/31/05	$ 8,871,500*
12/31/06	$ 3,271,471
12/31/07 (forecast)	$ 3,743,600**

*Includes RUS cushion of credit balance.
**Includes $4.8 million Wolf Creek capital additions loan

Table 5, below, shows that KEPCo also compares unfavorably with its peers on the equity as a percent of assets financial indicator. Its GAAP equity ratio is significantly lower than that of the peer G&T cooperative groups, its Members, and the investor-owned electric utilities group. The average equity as a percent of assets for the G&T cooperative peers for 1998 and 1999 was 22.3%. KEPCo's Members had equity ratios that averaged 43.4% for 1998-1999 and compared favorably with the normally higher investor-owned electric utility equity ratios which averaged 43.1% for the 1998-1999 period. By the end of 2005, the average equity ratio for the RUS borrower G&T cooperative group was 23.4%, it was 43.8% for the IOU group, 44.8% for the Members, and a negative 12.4% for KEPCo. Historically, KEPCo stated its equity based on the use of sinking fund depreciation for Wolf Creek (non-GAAP). Adjusting KEPCo's equity balance to reflect the use of straight-line depreciation (in accordance with GAAP), as RUS, credit rating agencies, financial analysts, and lenders normally do, results in a negative equity balance for

KEPCo. Even though KEPCo's prior use of sinking fund depreciation for Wolf Creek was required by an order of the KCC, that prior use of a depreciation method that is not in accordance with GAAP still carries negative consequences for KEPCo. The exception has to be noted by KEPCo's accountants in their review of KEPCo's financial statements and is not viewed favorably by RUS or the financial community.

Table 5: GAAP Equity as % of Assets

	1998	1999	2004	2005
Moody's Rated G&Ts (11)	20.1%	21.7%	N/A	N/A
RUS G&Ts (Over 30)	22.7%	24.8%	23.9%	23.4%
Investor-Owned Electrics	41.7%	44.5%	42.2%	43.8%
KEPCo Members	43.0%	43.8%	45.8%	43.8%
KEPCo	-19.6%	-21.5%	-16.6%	-12.4%

KEPCo 2000:	-23.6%
KEPCo 2001:	-29.5%
KEPCo 2002:	-24.6%
KEPCo 2003:	-19.9%
KEPCo 2004:	-16.6%
KEPCo 2005:	-12.4%
KEPCo 2006	-9.5%
KEPCo 2007 (forecast):	-5.5%

As evidenced by Table 5 and as recognized by Moody's and S&P, G&T cooperatives are not expected to maintain equity ratios as high as those of distribution cooperatives or investor-owned electric utilities. However, KEPCo falls woefully short on this key indicator of financial soundness, even without making any adjustment to reflect the requirements of GAAP. One of the reasons G&Ts are not expected to maintain equity ratios as high as other utilities is because G&Ts typically maintain relatively large cash balances. Moody's discusses this trade-off in its December 2000 special report on cooperative credit quality. In that report,

Moody's said "Because many G&T coops often carry large cash balances, this can sometimes compensate for the low level of equity that they carry on their balance sheets." Thus, in light of KEPCo's very low equity ratio, it should attempt to rebuild a reasonable level of cash balances as quickly as practicable. Over the longer term, however, KEPCo should also attempt to grow its equity ratio to a level more in line with those of its G&T peers. At this time, 20% is a reasonable long-term target ratio for KEPCo. Fortunately, over the long term as Wolf Creek gets closer and closer to being fully depreciated, the GAAP depreciation adjustment will become less and less of an issue. Adopting such a policy and demonstrating progress toward achieving the long-term target ratio will be an important factor in enabling KEPCo to access sources of capital on reasonable terms.

Support for the 20% equity ratio as a minimum target level is also found in KEPCo's RUS/CFC mortgage. Section 4.16 of the mortgage sets the 20% level as a minimum for allowing any capital credit refunds without getting a written approval from the mortgage holders. When the KEPCo Board adopted the 20% equity ratio target as we suggested in our 2001 Financial Plan, we estimated that KEPCo may be able to achieve a 20% level sometime within the 2011-2013 timeframe and it appears that it is still on track to do so, assuming the new rates are set using a 1.2 DSC, rather than a 1.2 TIER, to establish the margin component.

Turning now to the needed level of cash balances, we believe a reasonable target level for cash balances for KEPCo should be in the $14-$25 million range. While cash balances will naturally fluctuate up and down from month to month, KEPCo should target a minimum level of cash as of the end of each calendar year of $14 million. In its December 2000 "A Credit Perspective on U.S. Electric

Cooperatives", Moody's, in discussing the key financial indicators it focuses on in assessing the financial strength of electric cooperatives, says:

> Although G&T coops tend to have lower interest coverage relative to similarly rated IOUs, it is worth noting that there are other compensating factors for the thin coverages, including the relatively predictable revenue streams from distribution coops under the G&Ts all-requirements supply contracts and typically large cash balances on hand. (Emphasis added.)

As discussed above, Moody's cited typically large cash balances of G&T cooperatives as also being a reason why the G&Ts are not normally expected to carry equity ratios in the 40+% range as are expected for IOUs and others. It is even more important for KEPCo to maintain a healthy cash position due to its relatively unique position of (1) having such a low (negative under GAAP) equity position, (2) having used sinking fund depreciation for so long, and (3) having its rates regulated by a state utility commission. Furthermore, due to its low equity position and the fact that cash balances are primarily needed to meet current operational and short-term capital requirements, KEPCo should attempt to avoid borrowing to meet its cash balance needs. Therefore, KEPCo needs to rebuild its deteriorated cash balances through increased margins in its rates.

Table 6, below, shows some of the major requirements contributing to the need for a $14 million minimum level of cash.

Table 6: Quantification of Working Capital Requirement

$5-$7 million	Normal monthly swing in cash expenditures.
$2-$4 million	Normal monthly swing in revenues.
$1-$2 million	For abnormal weather conditions.
$2-$3 million	For possible power cost revenue lag.
$2-$3 million	For small capital additions.
$1-$3 million	For nuclear operating risks.
$1-$3 million	For other unquantified risks
$14-$25 million	

Rule of thumb: 2-4 months cash requirements on hand.
$14 - $25 million

Some of the major requirements contributing to the need for substantial cash balances are listed below:

(1) Normal month-to-month fluctuations in costs. KEPCo's cash expenditures historically have changed by as much as $5 million-$7 million from one month to the next. KEPCo experiences large, lumpy quarterly and semi-annual principal and interest payments. As a result, in some months, interest payments go from $100,000 one month to $3 million the next. Principal payments similarly swing by over $2 million between some months. In addition, property taxes are paid semi-annually at approximately $1.5 million each.

(2) Normal month-to-month fluctuations in cash receipts. KEPCo's cash receipts can change by as much as $2.5 million-$4.0 million from one month to the next.

(3) Abnormal weather can significantly exacerbate the swings in month-to-month cash flows.

(4) Monthly purchased power costs range from approximately $4 million-$9 million and generally become due from 15-20 days after the end of the month in which the service is received. The Member revenues also are normally received within a 10-25 day window after the service month. However, there are times when receipts and payments do not match appropriately and a significant portion of the purchased power costs must be paid prior to receipt of sufficient Member payments, at times, easily in excess of $2.0 to $3.0 million.

(5) Internally generated cash is needed for small capital additions. KEPCo will require approximately $2 to $3 million per year for Wolf Creek additions and improvements. In addition, other plant and equipment that allows ultimate cost savings or improvement in service to members is often financed with internally generated funds.

(6) The collection of internally generated cash above current O&M requirements is also necessary to build equity capital over time in order to fund a portion of major plant additions that might be required and improve KEPCo's balance sheet over time. As discussed more fully above, the need for improved financial and operating flexibility in the increasingly competitive environment; the need to demonstrate credit worthiness to prospective power suppliers; the potential need or desire to own additional or replacement generation in the future and to fund a portion of the cost with equity or, at least, demonstrate increased ability to take on additional debt; and the need to improve its financial

condition in the future, all require that KEPCo improve its balance sheet by adding a significant amount of equity in the coming years. That equity can only come from one source – cash net margins collected from members through KEPCo's wholesale power rates.

(7) KEPCo is exposed to significant nuclear operating risks. It needs cash on hand to provide short-term funding for unforeseen repair and other costs beyond normal plant maintenance, etc.

(8) Cash balances are required to build and maintain short-term liquidity and financial strength.

(9) Regulatory lag also causes the need for cash balances. KEPCo's rates are regulated by the KCC so they cannot be changed quickly as conditions change. Even though this concern may be lessened somewhat by the addition of a demand-related PPCA provision as part of KEPCo's upcoming rate filing, it will not be completely eliminated. A substantial portion of KEPCo's revenue requirements will continue to be collected through the remaining fixed portion of its rates. Also, while demand and energy cost adjustment provisions are commonplace for G&Ts, the December 2000 special report on cooperative credit issues by Moody's and the comparable November 2006 report by S&P cites regulation as a need for larger cash balances by the few G&Ts that are still subject to rate regulation by state commissions. Furthermore, KEPCo's rate lag is lengthened because it must first go through a Member Board of Trustees review before a rate application is filed with the Commission, thus increasing the time needed to put a new rate in place. Finally, regulation in Kansas is based on an historic test year with known and measurable adjustments rather than a projected test year making it more difficult to reflect cost increases on a timely basis.

(10) KEPCo also faces a significant need for the collection of additional cash through rates to make up for the growing short fall in the amount of cash recovered as a result of including depreciation and amortization expense in rates and the larger actual loan principal payments that must be made. That difference is in excess of $3.5 million in 2007 and is expected to grow to $5 million by 2009 and continue increasing annually to more than $10 million by 2015.

B. Produce Positive Margins from Operations

Moody's affirms the importance of KEPCo's second financial policy requirement of earning positive margins from operations (as opposed to depending

on non-operating income to generate positive margins). In its December 2000 special report on cooperative credit issues, Moody's said:

> Moody's also notes that many coops have large investment portfolios, which can add considerably to the bottom line. Nonetheless, we consider it very important for the coop to be profitable on an operating basis. We do not take a great deal of comfort in cases where some coops rely extensively on profits from investment portfolios and diversified operations to compensate for negative utility operating margins. (Emphasis added.)

As Table 7 below shows, KEPCo experienced positive operating margins in excess of $3 million in 1997 and 1998. Largely because of the late 1998 rate reduction and increasing purchased power costs that resulted from unanticipated increases in fuel costs, operating margins turned negative in 1999 and became progressively more negative until the rate increase implemented in 2002. From 2002 through 2006, KEPCo's operating margins were consistently positive, but had dropped to only $238,300 by 2006. The 2007 operating margin is forecast to be in excess of $1.2 million. Thus, KEPCo has been able to meet this policy objective over the last five or six years.

Table 7: KEPCo Operating Margins

Year	Operating Margin
1997	$3,056,000 (positive)
1998	$3,199,000 (positive)
1999	-$1,073,000 (negative)
2000	-$1,987,000 (negative)
2001	-$4,373,954 (negative)
2002	$2,569,190 (positive)
2003	$1,726,366 (positive)
2004	$2,581,000 (positive)
2005	$1,774,100 (positive)
2006	$238,300 (positive)
2007 (Est.)	$1,244,600 (positive)

C. Revenue from all Sources to Meet O&M Expenses

This requirement assures reaching at least the break-even point, and the other complimentary requirements of the financial policy help to achieve and maintain reasonable financial strength.

D. Revenue from all Sources to Maintain a Reasonable Level of Working Capital

The major reasons KEPCo needs working capital (or cash in excess of normal operations expenses) are listed and discussed above.

E. Meet all Mortgage Requirements

Section 4.15 of KEPCo's RUS/CFC mortgage requires that rates be designed to meet the following requirements:

(1) Cover all costs of operations.

(2) Provide for payment of principal and interest when due.

(3) Provide and maintain reasonable working capital.

(4) Maintain TIER and DSC of 1.05 and 1.00, respectively (average of the highest two out of every three years).

Section 4.16 of the mortgage provides that unless written waiver is granted, unrestricted capital credit payments are not allowed unless KEPCo's equity as a percent of assets is 30% or more after giving effect to any such payments. It also provides that if the equity ratio will remain in the 20%-29% range after giving effect to them, KEPCo may retire capital credits up to 25% of the prior year's net margin. If the equity ratio is less than 20%, a written waiver must be obtained for any capital credit retirements.

F. Pay Capital Credits on a Seven-Year Rotation Schedule

As discussed above, KEPCo's mortgage places significant restrictions on the payment of capital credits. Thus, without substantial improvement in KEPCo's balance sheet, and more specifically its equity-to-asset ratio, KEPCo cannot meet this prong of its financial policy. The obvious intention of the 20% and 30% equity ratio requirements by RUS and CFC for retiring substantial amounts of capital credits without written permission is to promote the development of strong balance sheets and the ability to withstand financial shocks. Thus, RUS and CFC recognize the need for achieving a reasonable level of equity as a percent of total assets. Our recommendations herein, thus, are clearly in line with the desires of KEPCo's major lenders.

It is our understanding that the Board will be considering a change to the seven-year rotation policy in favor of capital credit retirements as determined to be needed or appropriate to maintain cash balances at levels consistent with KEPCo's Financial Plan once the target thresholds are met. We see that as a reasonable course of action, but would point out that the above-described mortgage requirements would still have to be met even under such a revised capital credit retirement policy.

VIII. RECOMMENDATIONS

Our recommendations are as follows:

(1) Seek to build and maintain year-end cash balance of at least 2.5 months of average monthly cash expenditures – currently approximately $14 million for KEPCo. This recommendation is tempered toward the bottom end of the quantified range of $14 to $25 million in order to reflect the non-profit nature and minimum rate level characteristics of a cooperative enterprise.

(2) Maintain KEPCo's current line of credit of $15 million.

(3) Incorporate a demand-related purchased power adjustment provision in KEPCo's rates.

(4) Use an annual DSC target of 1.2 and a TIER target of 1.2 recognizing that it is the DSC target that will drive KEPCo's ratemaking revenue requirements for many years to come. If the demand-related PPCA is not included in KEPCo's rates, we recommend use of a 1.3 DSC target rather than 1.2, until such time as the target cash balances are reached and maintained on a consistent basis.

(5) Adopt a policy of continuing to build GAAP equity to a minimum of 20% of assets over the next four to six years.

(6) Evaluate KEPCo's progress in attaining these financial goals annually as a part of the regular rate review and reevaluate the targets in one to two years.

Section 16

Financial statements.

Section 16. ***Financial statements.*** **This section shall include a copy of the financial statements for the most recent fiscal year. These financial statements shall have been audited by an independent certified public accountant and an opinion rendered thereupon.**

Kansas Electric Power Cooperative, Inc.

Accountants' Reports and Consolidated Financial Statements

December 31, 2006 and 2005

Kansas Electric Power Cooperative, Inc.

Accountants' Reports and Consolidated Financial Statements

December 31, 2006 and 2005

Kansas Electric Power Cooperative, Inc.

December 31, 2006 and 2005

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Independent Accountants' Report

Board of Trustees
Kansas Electric Power Cooperative, Inc.
Topeka, Kansas

We have audited the accompanying consolidated balance sheet of Kansas Electric Power Cooperative, Inc. (the Cooperative) as of December 31, 2006, and the related consolidated statements of margin, patronage capital and cash flows for the year then ended. These financial statements are the responsibility of the Cooperative's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Cooperative as of and for the year ended December 31, 2005, were audited by other accountants, whose report dated April 7, 2006, on those statements was qualified because certain depreciation and amortization methods used do not conform to accounting principles generally accepted in the United States of America as discussed in the notes.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As explained in *Note 3*, certain depreciation and amortization methods have been used in the preparation of the 2006 financial statements which, in our opinion, are not in accordance with accounting principles generally accepted in the United States of America. The effects on the financial statements of the aforementioned departure are explained in *Note 3*.

In our opinion, except for the effects of using the aforementioned depreciation and amortization methods as discussed in *Note 3*, the 2006 consolidated financial statements referred to above present fairly, in all material respects, the financial position of the Cooperative as of December 31, 2006, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we also have issued our report dated April 5, 2007, on our consideration of the Cooperative's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

BKD LLP

April 5, 2007

Liabilities and Patronage Capital

	2006	2005
Patronage Capital		
Memberships	$ 3,200	$ 3,200
Patronage capital	19,497,487	18,450,805
Total patronage capital	19,500,687	18,454,005
Long-term Debt	142,272,490	149,908,644
Other Long-term Liabilities		
Wolf Creek decommissioning liability	16,332,466	13,916,214
Wolf Creek nuclear operating liabilities	2,589,872	2,443,767
Arbitrage rebate long-term liability	537,765	992,862
Other deferred credits	12,452	100,213
Total other long-term liabilities	19,472,555	17,453,056
Current Liabilities		
Current maturities of long-term debt	11,162,495	10,464,348
Line of credit	3,521,028	—
Accounts payable	7,958,739	7,750,203
Payroll and payroll-related liabilities	284,661	263,690
Accrued property taxes	1,319,875	1,294,342
Accrued interest payable	576,562	421,423
Total current liabilities	24,823,360	20,194,006
Total patronage capital and liabilities	$ 206,069,092	$ 206,009,711

Kansas Electric Power Cooperative, Inc.

Consolidated Statements of Margin

Years Ended December 31, 2006 and 2005

	2006	2005
Operating Revenues		
Sales of electric energy	$ 110,707,844	$ 101,933,017
Other	64,089	318,689
Total operating revenues	110,771,933	102,251,706
Operating Expenses		
Power purchased	73,351,849	63,050,719
Nuclear fuel	2,382,257	2,281,038
Plant operations	9,072,478	8,731,121
Plant maintenance	3,062,210	2,974,581
Administrative and general	5,069,698	4,901,614
Amortization of deferred charges	4,588,219	5,142,698
Depreciation and decommissioning	4,168,565	4,362,753
Total operating expenses	101,695,276	91,444,524
Net operating revenues	9,076,657	10,807,182
Interest and Other Deductions		
Interest on long-term debt	8,540,243	8,836,180
Amortization of debt issuance costs	125,431	129,895
Other deductions	172,704	67,315
Total interest and other deductions	8,838,378	9,033,390
Operating Income	238,279	1,773,792
Other Income (Expense)		
Interest income	875,646	853,209
Other income (expense)	(67,243)	824,856
Total other income	808,403	1,678,065
Net margin	$ 1,046,682	$ 3,451,857

Kansas Electric Power Cooperative, Inc.

Consolidated Statements of Patronage Capital

Years Ended December 31, 2006 and 2005

	Memberships	Patronage Capital	Total
Balance, December 31, 2004	$ 3,200	$ 14,998,948	$ 15,002,148
Net margin	—	3,451,857	3,451,857
Balance, December 31, 2005	3,200	18,450,805	18,454,005
Net margin	—	1,046,682	1,046,682
Balance, December 31, 2006	$ 3,200	$ 19,497,487	$ 19,500,687

Kansas Electric Power Cooperative, Inc.

Consolidated Statements of Cash Flows

Years Ended December 31, 2006 and 2005

	2006	2005
Operating Activities		
Net margins	$ 1,046,682	$ 3,451,857
Adjustments to reconcile net margin to net cash provided by operating activities		
Depreciation and amortization	3,704,711	3,911,449
Decommissioning	1,458,328	451,304
Amortization of nuclear fuel	1,748,780	1,681,987
Amortization of deferred charges	4,588,218	4,045,720
Amortization of deferred incremental outage costs	2,557,796	3,470,606
Amortization of debt issuance costs	125,432	129,895
Changes in		
Member accounts receivable	637,183	(1,326,340)
Materials and supplies	(156,089)	(42,261)
Other assets and prepaid expenses	120,250	(202,794)
Accounts payable	208,536	284,122
Payroll and payroll-related liabilities	20,971	(2,444)
Accrued property tax	25,533	(16,441)
Accrued interest payable	155,139	51,333
Restricted assets	(33,328)	(49,836)
Other long-term liabilities	(300,801)	249,471
Net cash provided by operating activities	15,907,341	16,087,628
Cash Flows From Investing Activities		
Additions to electric plant	(6,034,758)	(1,469,394)
Additions to nuclear fuel	(3,179,023)	(615,088)
Additions to deferred incremental outage costs	(4,078,059)	(3,556,885)
Investments in decommissioning fund assets	(1,292,261)	(451,304)
Other	20,047	—
Net cash used in investing activities	(14,564,054)	(6,092,671)
Cash Flows From Financing Activities		
Net borrowing under line of credit agreement	3,521,028	—
Principle payments on long-term debt	(10,464,348)	(9,907,800)
Increase in debt issuance costs related to debt refinancing	—	(670,489)
Utilization of RUS cushion of credit	3,526,341	698,771
Net cash used in financing activities	(3,416,979)	(9,879,518)
Net increase (decrease) in cash and cash equivalents	(2,073,692)	115,439
Cash and Cash Equivalents, Beginning of Year	5,345,163	5,229,724
Cash and Cash Equivalents, End of Year	$ 3,271,471	$ 5,345,163
Supplemental Cash Flows Information		
Cash paid during the year for interest	$ 8,385,104	$ 8,852,162

Note 1: Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

Kansas Electric Power Cooperative, Inc. and its subsidiary (KEPCo), headquartered in Topeka, Kansas, was incorporated in 1975 as a not-for-profit generation and transmission cooperative (G&T). KEPCo is under the jurisdiction of the Kansas Corporation Commission (KCC) and was granted a limited certificate of convenience and authority in 1980 to act as a G&T public utility. It is KEPCo's responsibility to procure an adequate and reliable power supply for its 19 distribution rural electric cooperative members pursuant to all requirements of its power supply contracts. KEPCo is governed by a board of trustees representing each of its 19 members, which collectively serve more than 100,000 electric customers in rural Kansas.

System of Accounts

KEPCo maintains its accounting records substantially in accordance with the Rural Utilities Service (RUS) Uniform Systems of Accounts and in accordance with accounting practices prescribed by the KCC.

Rates

The KCC has the authority to establish KEPCo's electric rates under state law in Kansas. Rates are established to meet the times-interest-earned ratio and debt-service coverage set forth by the RUS. KEPCo's rates include an energy cost adjustment (ECA) mechanism, which allows KEPCo to pass along increases in certain energy costs to its cooperative members.

Principles of Consolidation

The consolidated financial statements include the amounts of the Cooperative and its majority-owned subsidiary, KEPCo Services, Inc. Undivided interests in jointly owned generation facilities are consolidated on a pro rata basis. All material intercompany accounts and transactions have been eliminated in consolidation.

Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Utility Plant and Depreciation

Utility plant is stated at cost. The cost of repairs and minor replacements are charged to operating expenses as appropriate. Costs of renewals and betterments are capitalized. The original cost of utility plant retired and the cost of removal, less salvage, are charged to accumulated depreciation.

The composite depreciation rate for electric generation plant for the years ended December 31, 2006 and 2005, was 2.98% and 2.98%, respectively.

The provision for depreciation computed on a straight-line basis for electric and other components of utility plant is as follows:

Transportation and equipment	25 to 33 years
Office furniture and fixtures	10 to 20 years
Leasehold improvements	20 years
Transmission equipment	10 years

Nuclear Fuel

The cost of nuclear fuel in process of refinement, conversion, enrichment and fabrication is recorded as utility plant asset at original cost and is amortized to nuclear fuel expenses based upon the quantity of heat produced for the generation of electric power. The permanent disposal of spent fuel is the responsibility of the Department of Energy (DOE). KEPCo pays one cent per net MWh of nuclear generation to the DOE for the future disposal service. These disposal costs are charged to nuclear fuel expense.

Decommissioning Fund Assets/Decommissioning Liability

As of December 31, 2006 and 2005, approximately $9.2 million and $8 million, respectively, have been collected and are being retained in an interest-bearing trust fund to be used for the physical decommissioning of Wolf Creek Nuclear Generating Station (Wolf Creek). The trustee invests the decommissioning funds primarily in mutual finds, which are carried at estimated fair value. During 2003, the KCC extended the estimated useful life of Wolf Creek to 60 years from the original estimates of 40 years only for the determination of decommissioning costs to be recognized for ratemaking purposes. In 2006, the KCC approved a 2005 decommissioning cost study, which increased the estimate of total decommissioning costs to $517.6 million in 2005 dollars ($31.1 million is KEPCo's share). The study assumes a 4.4% rate of inflation and 7% rate of return.

KEPCo adopted Statement of Financial Accounting Standard (SFAS) No. 143, *Accounting for Asset Retirement Obligations*, on January 1, 2003. SFAS No. 143 provides accounting requirements for the recognition and measurement of liabilities associated with the retirement of tangible long-lived assets. Under the standard, these liabilities will be recognized at fair value as incurred and capitalized and depreciated over the appropriate period as part of the cost of the related tangible long-lived assets.

Kansas Electric Power Cooperative, Inc.
Notes to Consolidated Financial Statements
December 31, 2006 and 2005

SFAS No. 143 required KEPCo to recognize and estimate the liability for its 6% share of the estimated cost to decommission Wolf Creek, based on the present value of the asset retirement obligation KEPCo incurred at the time it was placed into service in 1985. On January 1, 2003, KEPCo initially recognized an asset retirement obligation of $11.7 million; utility plant in-service, net of accumulated depreciation, was increased by $2.9 million; and KEPCo also established a regulatory asset for $3.9 million, which represents the amount of the Wolf Creek asset retirement obligation and accumulated depreciation not yet refunded.

The decommissioning study in 2005 increased the asset retirement obligation by approximately $1.5 million, utility plant in-service, net of accumulated depreciation by $.2 million and the regulatory asset by $1.2 million in 2006.

A reconciliation of the asset retirement obligation for the years ended December 31, 2006 and 2005 is as follows:

	2006	2005
Balance at January 1	$ 13,916,214	$ 13,128,504
Accretion	938,420	787,710
Increase from 2005 study	1,477,832	—
Balance at December 31	$ 16,332,466	$ 13,916,214

Any net margin effects are deferred in the Wolf Creek decommissioning regulatory asset created pursuant to SFAS No. 71, *Accounting for the Effects of Certain types of Regulation*, and will be collected from members in future electric rates.

Cash and Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents and are stated at cost, which approximates fair value. Cash equivalents consist primarily of certificates of deposit.

Accounts Receivable

Accounts receivable are stated at the amount billed to members and customers. The Cooperative provides allowances for doubtful accounts, which is based upon a review of outstanding receivables, historical collection information and existing economic conditions.

Materials and Supplies Inventory

Materials and supplies inventory are valued at average cost.

Unamortized Debt Issuance Costs

Unamortized debt issue costs relate to the issuance of the floating/fixed rate pollution control revenue bonds, mortgage notes payable to the National Rural Utilities Cooperative Finance Corporation (CFC) trusts, and fees for repricing the Federal Financing Bank (FFB) debt. These costs are being amortized using the effective interest method over the remaining life of the bonds and notes.

Cash Surrender Value of Life Insurance Contracts

The following amounts related to Wolf Creek Nuclear Operating Corporation (WCNOC) corporate-owned life insurance contracts, primarily with one highly rated major insurance company, are included in other investments on the consolidated balance sheets.

	2006	2005
Cash surrender value of contracts	$ 4,693,922	$ 4,383,449
Borrowings against contracts	(4,693,922)	(4,383,449)
	$ 0	$ 0

Borrowings against contracts include a prepaid interest charge. KEPCo pays interest on these borrowings at a rate of 4.27% and 5.45% for the years ended December 31, 2006 and 2005, respectively.

Revenues

Revenues are recognized during the month the electricity is sold. Revenues from the sale of electricity are recorded based on usage by member cooperatives and customers and on contracts and scheduled power usages as appropriate.

Income Taxes

As a tax-exempt cooperative, KEPCo is exempt from income taxes under Section 501(c)(12) of the Internal Revenue Code of 1986, as amended. Accordingly, provisions for income taxes have not been reflected in the accompanying consolidated financial statements.

Reclassifications

Certain reclassifications have been made to the 2005 financial statements to conform to the 2006 financial statement presentation. These reclassifications had no effect on net earnings.

Note 2: Factors That Could Affect Future Operating Results

KEPCo currently applies accounting standards that recognize the economic effects of rate regulation pursuant to SFAS No. 71, *Accounting for the Effect of Certain Types of Regulation*, and accordingly has recorded regulatory assets and liabilities related to its generation and transmission operations. In the event KEPCo determines that it no longer meets the criteria of SFAS No. 71, the accounting impact could be a noncash charge to operations of an amount that would be material. Criteria that could give rise to the discontinuance of SFAS No. 71 include: (1) increasing competition that restricts KEPCo's ability to establish prices to recover specific costs, and (2) a significant change in the manner rates are set by regulators from a cost-based regulation to another form of regulation. KEPCo periodically reviews these criteria to ensure the continuing application of SFAS No. 71 is appropriate. Any changes that would require KEPCo to discontinue the application of SFAS No. 71 due to increased competition, regulatory changes or other events may significantly impact the valuation of KPECo's investment in utility plant, its investment in Wolf Creek and necessitate the write-off of regulatory assets. At this time, the effect of competition and the amount of regulatory assets that could be recovered in such an environment cannot be predicted.

The 1992 Energy Policy Act began the process of restructuring the United States electric utility industry by permitting the Federal Energy Regulatory Commission to order electric utilities to allow third parties to sell electric power to wholesale customers over their transmission systems. The Kansas legislature has not taken any significant action on industry restructuring that would have a direct impact on KEPCo. Management will continue to monitor deregulation initiatives, but does not presently expect any actions that would be unfavorable to KEPCo to be adopted within the next 12 months.

Note 3: Departures From Generally Accepted Accounting Principles

Effective February 1, 1987, the KCC issued an order to KEPCo requiring the use of present worth (sinking fund) depreciation and amortization. As more fully described in *Note 7,* such depreciation and amortization methods constituted phase-in plans that did not meet the requirements of SFAS No. 92, *Accounting for Phase-In Plans*.

Effective February 1, 2002, the KCC issued an order that extended the depreciable life of Wolf Creek from 40 years to 60 years. This order also permitted recovery in rates of the $53.5 million cumulative difference between historical present worth (sinking fund) depreciation and amortization and straight-line depreciation and amortization of Wolf Creek generation plant and disallowed costs over a 15-year period. As more fully described in *Note 7*, such depreciation and amortization methods constitute phase-in plans that do not meet the requirements of SFAS No. 92. Recovery of these costs in rates is included in operating revenues, and the related amortization expense is included in deferred charges in the consolidated statements of revenues and expenses. Investment gains related to the decommissioning fund are recorded as a reduction to the regulatory asset. KEPCo recorded gains of $0.9 million and $0.8 million in 2006 and 2005, respectively.

The effect of these departures from generally accepted accounting principles is to overstate (understate) the following items in the consolidated financial statements by the following amounts:

	2006	2005
Deferred charges	$ 35,636,341	$ 39,199,975
Patronage capital	35,636,341	39,199,975
Net margin	(3,563,634)	(3,563,634)

Note 4: Wolf Creek Nuclear Operating Corporation

KEPCo owns 6% of WCNOC, which is located near Burlington, Kansas. The remainder is owned by the Kansas City Power & Light Company (KCPL–47%) and Kansas Gas & Electric Company (KGE–47%). KGE is a wholly owned subsidiary of Westar Energy, Inc. KCPL is a wholly owned subsidiary of Great Plains Energy, Inc. KEPCo's undivided interest in WCNOC is consolidated on a pro rata basis. Substantially all of KEPCo's utility plant consists of its pro rata share of WCNOC. KEPCo is entitled to a proportionate share of the capacity and energy from WCNOC, which is used to supplement a portion of KEPCo's members' requirements. KEPCo is billed on a daily basis for 6% of the operations, maintenance, administrative and general costs and cost of plant additions related to WCNOC.

WCNOC disposes of all classes of its low-level radioactive waste at existing third-party repositories. Should disposal capability become unavailable, WCNOC is able to store its low-level radioactive waste in an on-site facility for up to five years under current regulations.

The Low-Level Radioactive Waste Policy Amendments Act of 1985 mandated that the various states, individually or through interstate compacts, develop alternative low-level radioactive waste disposal facilities. The states of Kansas, Nebraska, Arkansas, Louisiana and Oklahoma formed the Central Interstate Low-Level Radioactive Waste Compact (Compact) and the Compact Commission, which is responsible for causing a new disposal facility to be developed within one of the member states. The Compact Commission selected Nebraska as the host state for the disposal facility. WCNOC and the owners of the five other nuclear units in the Compact provided most of the preconstruction financing for this project.

In December 1998, the Nebraska agencies responsible for considering the developer's license application denied the application. Most of the utilities that had provided the project's preconstruction financing, including the WCNOC, as well as the Compact Commission itself, filed a lawsuit in federal court contending that Nebraska officials acted in bad faith while handling the license application. In September 2002, the court entered a judgment of $151.4 million, about one-third of which constitutes prejudgment interest, in favor of the Compact Commission and against Nebraska, finding that Nebraska had acted in bad faith in handling the license application. In August 2004, Nebraska and the Compact Commission settled this case. In August 2005, WCNOC received $19.6 million ($1.2 million is KEPCo's share) in proceeds from the Compact as a result of the settlement. In 2006, KEPCo received $0.1 million of interest income from the Compact.

Note 5: Investments in Associated Organizations

Investments in associated organizations are carried at cost. At December 31, 2006 and 2005, investments in associated organizations consisted of the following:

	2006	2005
CFC		
Memberships	$ 1,000	$ 1,000
Capital term certificates	395,970	395,970
Subordinated term certificates	2,205,000	2,205,000
Patronage capital certificates	25,134	16,566
Equity term certificates	592,743	631,150
	3,219,847	3,249,686
Other	152,306	142,514
	$ 3,372,153	$ 3,392,200

Note 6: Bond Fund Reserve

KEPCo has entered into a bond covenant whereby KEPCo is required to maintain, with a trustee, a bond fund reserve of approximately $4.3 million. This stipulated amount is sufficient to satisfy certain future interest and principal obligations. The amount held in the bond fund reserve is invested by the trustee in tax-exempt municipal securities, pursuant to the restrictions of the indenture agreement, which are carried at amortized cost.

Note 7: Deferred Charges

Disallowed Costs

Effective October 1, 1985, the KCC issued a rate order relating to KEPCo's investment in Wolf Creek, which disallowed $26.0 million of KEPCo's investment in Wolf Creek ($14.9 net of accumulated amortization as of December 31, 2006). A subsequent rate order, effective February 1, 1987, allows KEPCo to recover these disallowed costs and other costs related to the disallowed portion (recorded as deferred charges) for the period from September 3, 1985 through January 31, 1987, over a 27.736-year period starting February 1, 1987. Pursuant to a KCC rate order dated December 30, 1998, the disallowed portion's recovery period was extended to a 30-year period. Through December 31, 2001, KEPCo used the present worth (sinking fund) method to recover the disallowed costs, which enabled it to meet the times-interest-earned ratio and debt service requirements in the KCC rate order dated January 30, 1987. The method used by KEPCo through 2001 constituted a phase-in plan that did not meet the requirements of Statement of Financial Accounting Standard No. 92, *Accounting for Phase-In Plans* (SFAS No. 92).

Effective February 1, 2002, the KCC issued an order permitting recovery in rates of the $6.5 million cumulative difference between historical present worth (sinking fund) and straight-line amortization of Wolf Creek disallowed costs over a 15-year period. Such depreciation practice does not constitute a phase-in plan that meets the requirements of SFAS No. 92.

If the disallowed costs were recovered using a method in accordance with accounting principles generally accepted in the United States, the costs would have been expensed in their entirety upon implementation of the KCC order, with a corresponding decrease in patronage capital.

Wolf Creek Deferred Plant Costs

Effective February 1, 2002, the KCC issued an order permitting recovery in rates of the $46.9 million cumulative difference between historical present worth (sinking fund) depreciation and straight-line depreciation of Wolf Creek generation plant over a 15-year period. Such depreciation practice does not constitute a phase-in plan that meets the requirements of SFAS No. 92. In 2002, this cumulative difference was reclassified from utility plant allowance for depreciation to deferred charges on the consolidated balance sheets to reflect the amount as a regulatory asset. Amortization of the Wolf Creek deferred plant costs is included in amortization of deferred charges and amounts to $3.1 million for each of the years ended December 31, 2006 and 2005.

If the deferred plant costs were recovered using a method in accordance with accounting principles generally accepted in the United States, the costs would have been expensed in their entirety upon implementation of the KCC order, with a corresponding decrease in patronage capital.

Deferred Incremental Outage Costs

In 1991, the KCC issued an order that allowed KEPCo to defer its 6% share of the incremental operating, maintenance and replacement power costs associated with the periodic refueling of Wolf Creek. Such costs are deferred during each refueling outage and are being amortized over the approximate 18-month operating cycle coincident with the recognition of the related revenues. Additions to the deferred incremental outage costs were $4.1 million and $3.6 million in 2006 and 2005, respectively. The current year amortization of the deferred incremental outage costs was $2.6 million and $2.3 million in 2006 and 2005, respectively.

Other Deferred Charges

KEPCo includes in other deferred charges the early call premium resulting from refinancings. These early call premiums are amortized using the effective interest method over the remaining life of the new agreements.

Note 8: Short-Term Borrowings

As of December 31, 2005, KEPCo has a $15 million line of credit outstanding with the CFC. This line of credit has a term of 24 months. There were outstanding borrowings of $3,521,028 and $0 at December 31, 2006, and December 31, 2005, respectively. Interest varies and was 7.15% at December 31, 2006.

Note 9: Long-Term Debt

Long-term debt consists of mortgage notes payable to the United States of America acting through the FFB, the CFC and others. Substantially all of KEPCo's assets are pledged as collateral. The terms of the notes as of December 31 are as follows:

	2006	2005
Mortgage notes payable to the FFB at fixed rates varying from 3.616% to 9.206%, payable in quarterly installments through 2018*	$ 79,232,070	$ 81,792,204
Mortgage notes payable to the Grantor Trust Series 1997 at a rate of 7.522%, payable semiannually, principle payments commencing in 1999 and continuing annually through 2017	43,340,000	45,640,000
Floating/fixed rate pollution control revenue bonds, City of Burlington, Kansas, Pooled Series 1985C, variable interest rate (ranging from 3.53% to 3.64% at December 31, 2006) payable annually through 2015	26,700,000	28,500,000
Mortgage note payable and equity certificate loan to the National Rural Utilities Cooperative Finance Corporation at fixed rates of 5.95%, payable quarterly through 2017	4,162,915	4,440,788
	153,434,985	160,372,992
Less current maturities	11,162,495	10,464,348
	$142,272,490	$149,908,644

* The mortgage notes payable to FFB are presented net of $0 and $3,526,341 of cash deposited with the RUS for the future repayment of debt as of December 31, 2006 and 2005, respectively. These deposits are restricted for the future repayment of FFB debt and earn interest at a rate of 5%.

Aggregate maturities of long-term debt for the next five years and thereafter are as follows:

2007	$ 11,162,495
2008	11,950,139
2009	12,771,958
2010	13,689,904
2011	14,766,747
Thereafter	89,093,742
	$ 153,434,985

Restrictive covenants require KEPCo to design rates that would enable it to maintain a times-interest-earned ratio of at least one-to-one and debt-service coverage of at least one-to-one, on average, in at least two out of every three years. The covenants also prohibit distribution of net patronage capital or margins until, after giving effect to any such distribution, total patronage capital equals or exceeds 20% of total assets, unless such distribution is approved by RUS. KEPCo was in compliance with such restrictive covenants as of December 31, 2006 and 2005.

In 1997, KEPCo refinanced its mortgage notes payable to the 1988 CFC Grantor Trust through the establishment of a new CFC Grantor Trust Series 1997 (the Series 1997 Trust) by CFC. This refinancing reduced the guaranteed interest rate payable on the mortgage notes to a fixed rate of 7.522% through the use of an interest rate swap that was assigned by KEPCo to the Series 1997 Trust. The mortgage notes payable are prepayable at any time with no prepayment penalties. However, any termination costs relating to the termination of the assigned interest rate swaps is KEPCo's responsibility. At December 31, 2006, the termination obligation associated with the assigned swap agreement to early retire the mortgage notes payable is approximately $6.4 million. This fair value estimate is based on information available at December 31, 2006, and is expected to fluctuate in the future based on changes in interest rates and outstanding principal balance.

KEPCo also is exposed to possible credit loss in the event of noncompliance by the counterparty to the swap agreement. However, KEPCo does not anticipate nonperformance by the counterparty.

Note 10: Benefit Plans

National Rural Electric Cooperative Association (NRECA) Retirement and Security Program

KEPCo participates in the NRECA Retirement and Security Program for its employees. All employees are eligible to participate in this program after one year of service. In the master multi-employer plan, which is available to all members of NRECA, the accumulated benefits and plan assets are not determined or allocated by individual employees. KEPCo's expense under this program was $0.2 million for each of the years ended December 31, 2006 and 2005.

NRECA Savings 401(k) Plan

All employees of KEPCo are eligible to participate in the NRECA Savings 401(k) Plan. Under the plan, KEPCo contributes an amount not to exceed 5%, dependent upon each employee's level of participation and completion of one year of service, of the respective employee's base pay to provide additional retirement benefits. KEPCo contributed $0.1 million to the plan for each of the years ended December 31, 2006 and 2005.

WCNOC Retirement Plans

KEPCo has an obligation to the WCNOC retirement and supplemental retirement plans for its 6% ownership interest in Wolf Creek. The plans provide for benefits upon retirement, normally at age 65. In accordance with the Employee Retirement Income Security Act of 1974, KEPCo has satisfied its minimum funding requirements. Benefits under the plans reflect the employee's compensation, years of service and age at retirement.

Wolf Creek uses a measurement date of December 1 for its retirement plan and January 1 for its supplemental retirement plan.

The following sets forth KEPCo's share of the plans' changes in benefit obligation, plan assets and funded status as of December 31:

	2006	2005
Changes in benefit obligation		
Benefit obligation at beginning of year	$ 9,132,420	7,553,340
Service cost	414,240	359,940
Interest cost	548,040	476,160
Actuarial loss	168,840	869,580
Benefits paid	(151,320)	(126,600)
Benefit obligation at end of year	$ 10,112,220	$ 9,132,420
Accumulated benefit obligation	$ 7,958,220	$ 7,059,780

Plan assets are invested in insurance contracts, corporate bonds, equity securities, United States government securities and short-term investments.

	2006	2005
Changes in plan assets		
Fair value of plan assets at beginning of year	$ 5,074,740	$ 4,147,800
Actual return on plan assets	554,760	380,280
Contributions during the year	608,460	649,020
Benefits paid	(127,080)	(102,360)
Fair value of plan assets at end of year	$ 6,110,880	$ 5,074,740
Funded status	(4,001,340)	(4,057,680)
Unrecognized net actuarial loss	2,498,520	2,661,660
Unrecognized prior service cost	—	24,060
Unrecognized net transition obligation	—	43,560
Postmeasurement date adjustments	148,560	26,220
Accrued benefit cost	$ (1,354,260)	$ (1,302,180)
Actuarial assumptions used to determine benefit obligations		
Discount rate	5.70%	5.75%
Annual salary increase rate	3.25%	3.25%

The asset allocation for the plans at the end of 2006 and 2005, and the target allocation for 2006 by asset category are as follows:

	Target Allocation for 2006	Plan Assets	
		2006	2005
Asset category			
Equity securities	65%	63%	65%
Debt securities	35%	34	29
Other	0–5%	3	6
		100%	100%

WCNOC's pension plan investment strategy supports the objective fund, which is to earn the highest possible return on plan assets consistent with a reasonable and prudent level of risk. Investments are diversified across classes, sectors and manager style to minimize the risk of large losses. WCNOC delegates investment management to specialists in each asset class and, where appropriate, provides the investment manager with specific guidelines, which include allowable and/or prohibited investment types. Investment risk is measured and monitored on an ongoing basis through quarterly investment portfolio reviews.

KEPCo's share of the net periodic pension costs were as follows for the years ended December 31:

	2006	2005
Service cost	$ 414,240	$ 359,940
Interest cost on projected benefit obligation	548,040	476,160
Expected return on plan assets	(437,580)	(397,560)
Amortization of actuarial loss	231,420	171,060
Other	11,280	11,280
Total net periodic pension cost	$ 767,400	$ 620,880
Actuarial assumptions used to determine net periodic pension cost		
Discount rate	5.75%	6.00%
Expected return on plan assets	8.25%	8.75%
Annual salary increase rate	3.25%	3.00%

The expected return on plan assets is based on historical and projected rates of return for current and planned asset classes in the plans' investment portfolio. Assumed projected rates of return for each asset class were selected after analyzing long-term historical experience and future expectation of the volatility of the various asset classes. Based on the target asset allocations for each asset class, the overall expected rate of return for the portfolio was developed, adjusted for historical and expected experience of active portfolio management results compared to benchmark returns and for the effect of expenses paid from plan assets. In selecting the discount rate, fixed income security yield rates for corporate high-grade bond yields were considered.

KEPCo estimates cash contributions of $0.8 million will be made to the plans in 2007.

Estimated future benefit payments for the plans, which reflect expected future services, are as follows:

2007	$ 156,000
2008	186,000
2009	216,000
2010	258,000
2011	306,000
Thereafter	2,574,000
	$ 3,696,000

Wolf Creek Nuclear Operating Corporation (WCNOC) Postretirement Benefits

KEPCo has an obligation to the WCNOC postretirement plan for its 6% ownership interest in Wolf Creek. This plan provides certain medical benefits to participants upon retirement. KEPCo's 6% obligation is presented in Wolf Creek nuclear operating liabilities in the accompanying consolidated balance sheets and was $0.6 million and $0.5 million as of December 31, 2006 and 2005, respectively.

Note 11: Commitments and Contingencies

Litigation

There is a provision in the Wolf Creek operating agreement whereby the owners treat certain claims and losses arising out of the operation of Wolf Creek as a cost to be borne by the owners separately (but not jointly) in proportion to their ownership shares. Each of the owners has agreed to indemnify the others in such cases.

Nuclear Liability and Insurance

Pursuant to the Price-Anderson Act, which was reauthorized through December 31, 2025, by the Energy Policy Act of 2005, KEPCo is required to insure against public liability claims resulting from nuclear incidents to the full limit of public liability, which is currently approximately $10.8 billion. This limit of liability consists of the maximum available commercial insurance of $300.0 million, and the remaining $10.5 billion is provided through mandatory participation in an industrywide retrospective assessment program. Under this retrospective assessment program, owners are jointly and severally subject to an assessment of up to $100.6 million ($6.0 million–KEPCo's share) at any commercial reactor in the country, payable at no more than $15.0 million ($0.9 million–KEPCo's share) per incident per year, per reactor. This assessment is subject to an inflation adjustment based on the Consumer Price Index and applicable premium taxes. This assessment also applies in excess of the worker radiation claims insurance. The next scheduled inflation adjustment is scheduled for July 1, 2008. In addition, Congress could impose additional revenue-raising measures to pay claims.

The owners of Wolf Creek carry decontamination liability, premature decommissioning liability and property damage insurance for Wolf Creek totaling approximately $2.8 billion ($168.0 million–KEPCo's share). This insurance is provided by Nuclear Electric Insurance Limited (NEIL). In the event of an accident, insurance proceeds must first be used for reactor stabilization and site decontamination in accordance with a plan mandated by the Nuclear Regulatory Commission. KEPCo's share of any remaining proceeds can be used to pay for property damage, decontamination expenses, or if certain requirements are met, including nuclear decommissioning the plant, toward a shortfall in the decommissioning trust fund.

The owners also carry additional insurance with NEIL to cover costs of replacement power and other extra expenses incurred during a prolonged outage resulting from accidental property damage at Wolf Creek. If significant losses were incurred at any of the nuclear plants insured under the NEIL policies, KEPCo may be subject to retrospective assessments under the current policies of approximately $1.6 million.

Although KEPCo maintains various insurance policies to provide coverage for potential losses and liabilities resulting from an accident or an extended outage, KEPCo's insurance may not be adequate to cover the costs that could result from a catastrophic accident of extended outage at Wolf Creek. Any substantial losses not covered by insurance, to the extent not recoverable through rates, would have a material adverse effect on KEPCo's financial condition and result of operations.

Decommissioning Insurances

KEPCo carries premature decommissioning insurance that has several restrictions, one of which can only be used if Wolf Creek incurs an accident exceeding $500.0 million in expenses to safely stabilize the reactor, to decontaminate the reactor and reactor station site in accordance with a plan approved by the Nuclear Regulatory Commission (NRC) and to pay for on-site property damages. Once the NRC property rule requiring insurance proceeds to be used first for stabilization and decontamination has been complied with, the premature decommissioning coverage could pay for the decommissioning fund shortfall in the event an accident at Wolf Creek exceeds $500.0 million in covered damages and causes Wolf Creek to be prematurely decommissioned.

Nuclear Fuel Commitments

At December 31, 2006, KEPCo's share of WCNOC's nuclear fuel commitments was approximately $9.6 million for uranium concentrates expiring in 2017, $1.3 million for conversion expiring in 2017, $18.6 million for enrichment expiring at various times through 2024, and $6.8 million for fabrication through 2024.

Purchase Power Commitments

KEPCo has supply contracts with various utility companies to purchase power to supplement generation in the given service areas. KEPCo has a five-year contract with Westar Energy, Inc., through May 2008 with minimum purchase commitments of 85 megawatts per year.

KEPCo has provided the Southwest Power Pool a letter of credit to help insure power is available if needed.

Note 12: Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value as set forth in SFAS No. 107, *Disclosures about Fair Value of Financial Instruments.*

Cash and Cash Equivalents – The carry amount approximates the fair value because of the short-term maturity of these investments.

Decommissioning Trust, Investments in Associated Organizations and Bond Fund Reserve – The fair value of these assets is primarily based on quoted market prices as of December 31, 2006.

Variable-Rate Debt – The carrying amount approximates the fair value because of the short-term variable rates of those debt instruments.

Fixed-Rate Debt – The fair value of the fixed-rated FFB debt and the fixed-rate Series 1997 Trust debt is based on the sum of the estimated value of each issue, taking into consideration the current rates offered to KEPCo for debt of similar remaining maturities.

The estimated fair values of KEPCo's financial instruments are as follows:

	December 31, 2006	
	Carrying Value	Fair Value
Cash and cash equivalents	$ 3,271,471	$ 3,271,471
Investments in associated organizations (including investments in CFC)	3,372,153	3,372,153
Bond fund reserve	4,295,806	4,479,135
Decommissioning fund	9,245,665	9,245,665
Fixed-rate debt	126,734,987	126,178,186
Variable-rate debt	26,700,000	26,700,000

Note 13: Patronage Capital

In accordance with KEPCo's by-laws, KEPCo's current margins are to be allocated to members. KEPCo's current policy is to allocate to the members based on revenues collected from the members as a percentage of total revenues. If KEPCo's consolidated financial statements were adjusted to reflect accounting principles generally accepted in the United Stated of America, total patronage capital would be negative. As noted in the consolidated statements of changes in patronage capital, no patronage capital distributions were made to members in 2006 and 2005.

Note 14: Future Change in Accounting Principle

The FASB recently issued Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans* (SFAS 158), which revises the accounting and disclosure requirements in the financial statements of employers with respect to defined benefit pension and other postretirement plans. The statement requires an employer to currently recognize the funded status of defined benefit plans, the difference between the fair value of plan assets and the projected benefit obligation on the employers' balance sheet. SFAS 158 is effective for fiscal years ended after June 15, 2007; thus, the Cooperative expects to first apply the recognition of the funded status during its year ending December 31, 2007. Additionally, the statement has eliminated the current measurement option and requires the measurement date to be as of the balance sheet date for fiscal year ending after December 15, 2008. The Cooperative's measurement date is currently as of the balance sheet date.

Independent Accountants' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

Board of Trustees
Kansas Electric Power Cooperative, Inc.
Topeka, Kansas

We have audited the consolidated financial statements of Kansas Electric Power Cooperative, Inc. (the Cooperative) as of and for the year ended December 31, 2006, and have issued our report thereon dated April 5, 2007, which expresses a qualified opinion because of a departure from accounting principles generally accepted in the United States of America. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Cooperative's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Cooperative's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Cooperative's internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or a combination of control deficiencies, that adversely affects the Cooperative's ability to initiate, authorize, record, process or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Cooperative's financial statements that is more than inconsequential will not be prevented or detected by the Cooperative's internal control. We consider the deficiencies described in the accompanying schedule of findings and responses as items 06-01 and 06-02 to be significant deficiencies in internal control over financial reporting.

A material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Cooperative's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, of the significant deficiencies described above, we consider items 06-01 and 06-02 to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Cooperative's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We also noted certain additional matters that we reported to the Cooperative's management in a separate letter dated April 5, 2007.

This report is intended solely for the information and use of the governing body, management and others within the Cooperative and is not intended to be and should not be used by anyone other than these specified parties.

BKD LLP

April 5, 2007

Kansas Electric Power Cooperative, Inc.

Schedule of Findings and Responses

Year Ended December 31, 2006

Reference Number	Finding
06-01	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – One person has the ability to perform substantially all accounting duties while having access to highly liquid assets. Effect – Potential material misstatements in the financial statements or material misappropriation of assets due to error or fraud could occur and not be prevented or detected in a timely manner. Cause – Duties in the accounting department are not adequately segregated, and monitoring or other compensating controls are insufficient. Recommendation – Management should periodically evaluate the costs vs. the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions – Management has reviewed the finding and determined that limiting the person's ability to effect wire transfers and not have security administration duties would help eliminate this weakness. As a result, the financial institution where wire transfers are made has been instructed to not accept wire transfer requests from this person and the security administration duties have been transferred to the financial institution.

Kansas Electric Power Cooperative, Inc.

Schedule of Findings and Responses

Year Ended December 31, 2006

Reference Number	Finding
06-02	Criteria or Specific Requirement – Management is responsible for establishing and maintaining effective internal control over financial reporting. Condition – One person has incompatible duties in the sales transactions cycle. Context – One person has the ability to perform substantially all accounting functions of the sales cycle while receiving and being custodian over customer payments. Cause – Duties in the sales cycle are not adequately segregated, and monitoring or other compensating controls are insufficient. Recommendation – Management should periodically evaluate the costs vs. the benefits of further segregation of duties or addition of monitoring or other compensating controls and implement those changes it deems appropriate for which benefits are determined to exceed costs. Views of Responsible Officials and Planned Corrective Actions – Management has reviewed the finding and determined that limiting the person's access to customer payments would help eliminate this weakness. As a result, another person has been included in the process of receiving and depositing payments received. An additional review of the original deposit to a listing of payments received has also been included.